

**U.S. VULNERABILITIES TO MONEY  
LAUNDERING, DRUGS, AND TERRORIST  
FINANCING: HSBC CASE HISTORY**

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**HEARING**

BEFORE THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS  
OF THE

COMMITTEE ON  
HOMELAND SECURITY AND  
GOVERNMENTAL AFFAIRS  
UNITED STATES SENATE  
ONE HUNDRED TWELFTH CONGRESS

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**U.S. VULNERABILITIES TO MONEY  
LAUNDERING, DRUGS, AND TERRORIST  
FINANCING: HSBC CASE HISTORY**

**TUESDAY, JULY 17, 2012**

U.S. SENATE,  
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,  
OF THE COMMITTEE ON HOMELAND SECURITY  
AND GOVERNMENTAL AFFAIRS,  
*Washington, DC.*

The Subcommittee met, pursuant to notice, at 9:36 a.m., in room SD-342, Dirksen Senate Office Building, Hon. Carl Levin, Chairman of the Subcommittee, presiding.

Present: Senators Levin and Coburn.

Staff Present: Elise J. Bean, Staff Director/Chief Counsel; Mary D. Robertson, Chief Clerk; Laura E. Stuber, Senior Counsel; Robert L. Roach, Counsel and Chief Investigator; Eric Walker, Detailee; Kristin Gwin, Congressional Fellow; Christopher Barkley, Staff Director to the Minority; Keith B. Ashdown, Chief Investigator to the Minority; Adam Henderson, Professional Staff Member; Dennis Bogucz, Congressional Fellow; Brian Egger, Detailee; Beth Baltzan, Congressional Fellow; Noah Czarny, Law Clerk; Bill Gaertner, Law Clerk; Curtis Kowalk, Law Clerk; Lane Powell, Law Clerk; Arielle Woronoff, Law Clerk; Sofia Knutsson, Intern; and Jacquelyn Jones, Law Clerk.

**OPENING STATEMENT OF SENATOR LEVIN**

Senator LEVIN. Good morning, everybody. Today's hearing will examine the money-laundering, drug-trafficking, and terrorist-financing risks created in the United States when a global bank uses its U.S. affiliate to provide U.S. dollars and access to the U.S. financial system to a network of high-risk affiliates, high-risk correspondent banks, and high-risk clients.

Most international banks have a U.S. affiliate. They use it in part to compete for U.S. clients and business, but also to provide themselves with access to the U.S. financial system. Global banks want access to U.S. dollars because they are accepted internationally, they are the leading trade currency, and they hold their value better than any other currency. They want access to U.S. wire transfer systems because they move money across international lines quickly, securely, and to the farthest corners of the Earth. They want to clear U.S. dollar monetary instruments like travelers checks, bank checks, and money orders. And they want the safety, efficiency, and reliability that are the hallmarks of U.S. banking.

(1)

The problem here is that some international banks abuse their U.S. access. Some allow affiliates operating in countries with severe money-laundering, drug-trafficking, or terrorist-financing threats to open up U.S. dollar accounts without establishing safeguards at their U.S. affiliate. Some operate in secrecy jurisdictions. Some allow poorly managed or corrupt foreign banks to make use of an affiliate's U.S. dollar account. Others allow high-risk clients to use those accounts without taking adequate anti-money laundering (AML) steps. Some even allow their affiliates to pressure their U.S. cousins to ease up on U.S. AML restrictions or look the other way when they spot suspicious activity. The end result is that the U.S. affiliate can become a sinkhole of risk for an entire network of bank affiliates and their clients around the world playing fast and loose with U.S. rules.

The consequences are the ones you would expect from operating a U.S. bank with inadequate safeguards against money laundering. The U.S. bank can end up aiding and abetting transactions that fund terrorists, drug cartels, corrupt dictators, and tax cheats, because all of them want access to the U.S. financial system, too, and for the same reasons. Wrongdoers can use U.S. dollars and U.S. wire transfers to commit crimes, arm terror groups, produce and transport illegal drugs, loot government coffers, and even pursue weapons of mass destruction. That is why our country has made combating money laundering and terrorist financing a national security imperative.

For the last decade, this Subcommittee has contributed to the battle against money laundering and terrorist financing by exposing problems that increase U.S. vulnerabilities to abuse. In 2001, for example, this Subcommittee released a report showing how U.S. banks that offer accounts to foreign banks, engaging in what is known as correspondent banking, can become conduits for illegal proceeds involving organized crime, drug trafficking, or financial fraud. Back then, most U.S. banks opened a correspondent account for any foreign bank with a banking license. After our hearing, U.S. banks took a harder look and assessed the risks before opening a correspondent account. In 2002, Congress cited our hearings when enacting tougher AML laws in the PATRIOT Act, including in that Act a provision making it a legal obligation for U.S. banks to conduct a due diligence review before opening an account for a foreign bank.

Tougher AML laws have helped deny criminals access to the U.S. financial system. But as our report that we are releasing today shows, enormous problems remain.

To illustrate those problems, today's hearing focuses on a case study involving HSBC, one of the largest banks in the world. Headquartered in London, HSBC has a network of over 7,200 offices in more than 80 countries, 300,000 employees, and 2011 profits of nearly \$22 billion. HSBC has been among the most active banks in Asia, the Middle East, and Africa. It first acquired a U.S. presence in the 1980s; today its leading U.S. affiliate is HSBC Bank USA, sometimes called "H-BUS." That HBUS affiliate now has 470 branches across the United States and 4 million customers here.

HBUS is the key U.S. nexus for the entire HSBC worldwide network. In 2008, HBUS processed 600,000 wire transfers per week; in 2009, two-thirds of the U.S. dollar payments that HBUS processed came from HSBC affiliates in other countries. One HSBC executive told us that a major reason why HSBC opened its U.S. bank was to provide its overseas clients with a gateway into the U.S. financial system.

Now, add on top of that, HBUS's history of weak AML controls, and you have a recipe for trouble. In 2003, the Federal Reserve and New York State Banking Department took a formal enforcement action requiring HBUS to revamp its AML program. HBUS, which was then converting to a nationally chartered bank under the supervision of the Office of the Comptroller of the Currency (OCC) made changes, but even before the OCC lifted its order in 2006, the bank's AML program began deteriorating. In September 2010, the OCC issued a supervisory letter, 31 pages long, describing a long list of severe AML deficiencies, and followed in October 2010 with a cease and desist order requiring HBUS to revamp its AML program a second time.

The OCC cited, among other problems, a massive backlog of unreviewed alerts identifying potentially suspicious activity; a failure to monitor \$60 trillion in wire transfers and account activity; a failure to examine risks at HSBC's overseas affiliates before providing them correspondent banking services; and a failure, over a 3-year period, to conduct AML checks on more than \$15 billion in bulk cash transactions with those same affiliates.

To examine the issues, the Subcommittee issued subpoenas, reviewed more than 1.4 million documents, and conducted extensive interviews with HSBC officials from around the world, as well as officials at other banks, and with Federal regulators. HSBC has cooperated fully with our investigation.

The Subcommittee's work identified five key areas of vulnerability exposed by the HSBC history. The five areas involve the following:

First, providing U.S. correspondent accounts to high-risk HSBC affiliates without performing due diligence, including a Mexican affiliate with unreliable AML controls.

Second, failing to stop deceptive conduct by HSBC affiliates to circumvent a screening device designed to block transactions by terrorists, drug kingpins, and rogue nations like Iran;

Third, providing bank accounts to overseas banks with links to terrorist financing;

Fourth, clearing hundreds of millions of dollars in bulk U.S. dollar travelers checks, despite serious suspicious circumstances;

And, finally, offering bearer share accounts, a high-risk account that invites wrongdoing by facilitating hidden corporate ownership.

Let us take each in turn.

First, the issue of high-risk affiliates. HSBC operates affiliates in 80 countries, including jurisdictions facing major money-laundering, drug-trafficking, or terrorist-financing challenges as well as weak AML laws and oversight. Yet, until recently, HSBC's London-based parent company, known as the HSBC Group, instructed its affiliates to assume that every HSBC affiliate met the group's AML standards and automatically was told to provide it with correspon-

dent banking services. HBUS did as told and opened U.S. correspondent accounts for more than 80 HSBC affiliates, ignoring our law, the American law requiring due diligence reviews before opening U.S. accounts for foreign banks.

HBUS's dealings with an HSBC affiliate in Mexico illustrate the money laundering dangers. HSBC Mexico (HBMX), operates in a high-risk country battling drug cartels; it has had high-risk clients such as casas de cambios; and it has offered high-risk products such as U.S. dollar accounts in the Cayman Islands, a jurisdiction known for secrecy and money laundering. HBMX also has a long history of severe AML deficiencies. You add all that up and the U.S. bank should have treated HBMX, the Mexican affiliate, as a high-risk account for AML purposes. But it did not.

Instead, HBUS treated HBMX as such a low-risk client bank that it did not even monitor their account activity for suspicious transactions. In addition, for 3 years, from mid-2006 to mid-2009, HBUS conducted no monitoring of a banknotes account used by HBMX to physically deposit billions of U.S. dollars from clients, even though large cash transactions are inherently risky and Mexican drug cartels launder U.S. dollars from illegal drug sales. Because our tough AML laws in the United States have made it hard for drug cartels to find a U.S. bank willing to accept huge unexplained deposits of cash, they now smuggle U.S. dollars across the border into Mexico and look for a Mexican bank or casa de cambio willing to take the cash. Some of those casas de cambios had accounts at HBMX, which in turn took all the physical dollars that it got, transported them by armored car or aircraft back across the border to HBUS for deposit into its U.S. banknotes account, completing the laundering cycle.

Over 2 years, from 2007 to 2008, HBMX shipped \$7 billion in physical U.S. dollars to HBUS. That was more than any other Mexican bank, even one twice HBMX's size. When law enforcement and bank regulators in Mexico and the United States got wind of the banknotes transactions, they warned HBMX and HBUS that such large dollar volumes were red flags for drug proceeds moving through the HSBC network. In 2008, after warnings from regulators, HBMX stopped taking large deposits of U.S. dollars, but for years, HBUS provided an easy gateway into our financial system for suspicious cash from their foreign affiliate in Mexico.

Next, a second problem involves actions taken by some HSBC affiliates to circumvent a U.S. ban on bank transactions involving designated drug traffickers, terrorists, or rogue regimes such as Iran. To enforce that ban, the U.S. Treasury Department's Office of Foreign Assets Control (OFAC) has developed a list of prohibited persons which banks use to develop what is known as an "OFAC filter" to identify and stop prohibited or suspicious transactions.

The Subcommittee found that for years HSBC affiliates in Europe and the Middle East acted to circumvent the OFAC filter when sending U.S. dollar transactions involving Iran through their accounts at HBUS. Although they viewed these transactions as legal under a U.S. exception for so-called "U-turn" transactions, the affiliates did not want to trigger the OFAC filter and undergo the individualized reviews required to make sure that they were legal. So they stripped out or omitted any reference to Iran from the pa-

perwork. An outside auditor hired by HBUS has found that, from 2001 to 2007, HSBC affiliates sent nearly 25,000 transactions involving Iran, worth over \$19 billion, through HBUS and other U.S. accounts while concealing any link to Iran in 85 percent of the transactions.

HSBC's chief compliance officer and other senior executives in London knew what was going on, but allowed the deceptive conduct to continue. While some HBUS officials in the United States claim not to have known they were processing undisclosed Iranian transactions, documents show that key HBUS officials were informed early on. HBUS compliance and payment executives repeatedly told HSBC affiliates that they had to use fully transparent Iranian transactions, but when faced with evidence that the affiliates were secretly circumventing the OFAC filter, nobody in HBUS confronted those affiliates, brought the issue to a head, and forced the transactions to the light. Problems also arose when some HSBC affiliates tried to circumvent the OFAC filter to send potentially prohibited transactions involving other countries like Sudan or North Korea.

OFAC programs are aimed at exposing and disabling the financial dealings of some of the most dangerous persons and regimes in the world, including terrorists, persons involved with weapons of mass destruction, drug traffickers, and rogue jurisdictions. The OFAC filter is the key to blocking prohibited transactions from polluting the U.S. financial system. Global financial institutions have a special responsibility to respect OFAC prohibitions, but that is not what happened here. While HSBC affiliates may have been aiming simply at avoiding processing delays, circumventing OFAC safeguards can also facilitate transactions undertaken by some of the world's worst wrongdoers.

A third issue involves the fact that HSBC is active in regions of the world with significant terrorism challenges while demonstrating a worrisome willingness to do business with banks that have links to terrorist financing. One example involves Al Rajhi Bank, the largest private bank in Saudi Arabia. After the September 11, 2001 terrorist attack on the United States, evidence emerged that the bank's key founder was an early financial benefactor of al-Qaeda and that it provided accounts to suspect clients.

In 2005, HSBC Group told its affiliates to sever ties with that bank, but they made an exception for HSBC Middle East. Four months later, without explaining why, HSBC Group reversed itself and said that all of its affiliates could decide whether to do business with Al Rajhi Bank. HBUS chose to close its Al Rajhi accounts. Over the next 2 years, however, its own bankers and bankers from other HSBC affiliates pressed HBUS to resume ties with Al Rajhi Bank. And in 2006, after Al Rajhi Bank threatened to pull all of its business from HSBC unless HBUS reinstated its U.S. dollar banknotes account, HSBC gave in. And over the next 4 years, HBUS supplied Al Rajhi Bank with nearly \$1 billion in U.S. dollars, stopping only when HSBC made a global decision to exit the banknotes business altogether.

The fourth area of concern involves HBUS's willingness to clear suspicious bulk travelers checks for foreign banks. From 2005 to 2008, on a regular basis, HBUS cleared \$500,000 or more per day

in bulk travelers checks for the Hokuriku Bank of Japan. Routinely, these checks arrived in large stacks of sequentially numbered checks signed and countersigned with the same illegible signature. Forced by the Office of the Comptroller (OCC) of the Currency—to investigate, HBUS found the Japanese bank could not provide any “know your client” information or any explanation of why two dozen of its customers, supposedly in the used-car business, were often depositing \$500,000 a day in U.S. dollar travelers checks purchased from the same bank in Russia. Under OCC pressure, HBUS stopped clearing the travelers checks in 2008, but kept open the correspondent account, despite the Japanese bank’s poor AML controls. In less than 4 years, HBUS provided over \$290 million in U.S. dollars to a Japanese bank for the benefit of Russians, again, supposedly in the used-car business.

Finally, there is HBUS’s willingness to offer accounts to bearer share corporations. These corporations are prime vehicles for money laundering and other illicit activity by providing anonymity through assigning legal ownership of the corporation to whoever has physical possession of its shares. Over a decade, HBUS opened accounts for 2,000 such corporations, despite warnings by internal auditors and outside regulators that the accounts posed high money-laundering risks. Documents show that the actual account owners deliberately pressured the bank to help hide their identities. One such account was used by a father-son team of Miami Beach hotel developers who were later convicted of tax fraud for hiding \$150 million in assets.

Bearer share accounts, suspicious travelers checks, banks with terrorist-financing links, hidden transactions dodging OFAC safeguards, and Mexican drug money—none of them represent the types of transactions we want in a U.S. bank. If the parent corporation of a global bank cannot do a better job policing its affiliates, we should not be providing a bank charter to their U.S. affiliate. If the U.S. affiliate cannot do a better job of standing up to affiliate pressures and safeguarding the U.S. financial system, Federal regulators should consider whether to pull its charter.

HSBC Group recently issued a policy statement declaring that all of its affiliates would be subject to the highest AML standards among them; that its affiliates would start sharing information to strengthen their AML defenses; and that all affiliates would be subject to diligence reviews. HBUS has more than doubled the size of its AML compliance department, put in a new AML monitoring system, and closed over 395 high-risk correspondent accounts. These are all good steps, but we saw this movie before in 2003. The recent commitments are welcome. Apologies and commitments to improve are also welcome. But accountability for past conduct is essential, and that is what has been missing here.

It is bad enough that a single bank such as HSBC exposes the U.S. financial system to multiple-money laundering risks. It is made worse when there is a failure of anti-money laundering oversight by the regulator which is supposed to oversee our biggest banks—the OCC. It is of great concern to the Subcommittee, and it should be of great concern to every American, that the OCC tolerated the mounting AML problems at HBUS for 5 years, without taking any formal or informal enforcement action. In addition,

when the OCC decided the problems had gone far enough, it lowered HBUS's consumer compliance rating instead of its safety and soundness rating. Every other Federal banking agency treats anti-money laundering deficiencies as a matter of safety and soundness of the bank. Only the OCC treats anti-money laundering deficiencies as if they were a matter of consumer protection law. Anti-money laundering safeguards are not aimed at protecting bank customers; they are aimed at protecting the entire American public from wrongdoers seeking to misuse the U.S. financial system.

The new leadership at the OCC needs to move swiftly to correct the previous oversight shortfalls and to assure that promised changes at HSBC are implemented promptly and effectively.

Our report contains many recommendations to address the abuses that we have identified. Among the most important are the following:

HBUS should identify which of its sister affiliates are high risk, subject them to enhanced monitoring, and in particular, review whether it should close the account of HSBC's Mexican affiliate.

HBUS should beef up its OFAC compliance program by auditing affiliate transactions to see if they are circumventing the safeguards that protect our country and other countries from terrorists, drug traffickers, and rogue jurisdictions.

HBUS should close accounts with banks suspected of involvement in terrorist financing, revamp its travelers check controls, and eliminate bearer share accounts.

HSBC should require affiliates to share information to strengthen their anti-money laundering defenses, and should continue to beef up its compliance program which was given short shrift in the past.

At the OCC, the agency should follow the lead of other regulators and treat anti-money laundering compliance as a matter of safety and soundness of banks.

The new OCC leadership needs to get the OCC moving against money laundering by identifying statutory violations, not just identifying failures of banks as Matters Requiring Attention, in the face of significant anti-money laundering deficiencies.

Global banks have caused the world a lot of heartache. Our focus today is one global bank that failed to comply with rules aimed at combating terrorism, drug trafficking, and the money laundering that fuels so much of what threatens the global community. I want to thank my staff for their extraordinary work. I want to thank Senator Coburn for all of his support and for the work of his staff. And I now turn to him for his opening statement.

#### **OPENING STATEMENT OF SENATOR COBURN**

Senator COBURN. Thank you, Mr. Chairman. I normally submit an opening statement for the record and make a few short comments. I will not do that today because of the gravity of the problem that we face, and I want to make sure my words are heard and part of the record.

I agree with most of what we heard Senator Levin say. I want to thank him for his tireless work on this issue. He is one of my favorite bulldogs in terms of when he gets a hold of something, he really does not let go of it. I do not always agree with the number

of teeth that he loses when he grabs hold of it, but the fact is that he does grab hold of it.

I would also like to thank both the Office of the Comptroller of the Currency and HSBC Bank, and the reason I am thanking them is because in the years that I have been on this Subcommittee and this Committee, which is 8 years now, I have never seen the type of cooperation that we received both from a government agency and a private entity. OCC provided a number of people for interviews as well as essential documents about the regulatory process. HSBC Bank officials likewise sat for dozens of interviews and handed over millions of pages of documents. Some of today's witnesses were flown in from posts around the world.

As Chairman Levin laid out in his statement, the Subcommittee's investigation into anti-money laundering and anti-terror finance efforts at HSBC has covered quite a bit of ground. PSI examined in detail the types of vulnerabilities our Nation faces from criminals and terrorists who want to take advantage and abuse our banking system and take away our freedoms. What we learned is that the United States faces some very unique risks, both because of our post-September 11, 2001 security needs and because of the strength of our financial system, which attracts worldwide attention.

Every day, countless transactions denominated in U.S. dollars occur around the world. This is good for our economy, which benefits from a strengthened currency and increased economic activity. But criminals around the globe are also drawn to U.S. banks, which offer the attractive option of making illicit funds look legitimate. If they can pass criminal proceeds through a U.S. bank unnoticed and untouched, the funds are unlikely ever to be stopped or ever be recovered.

This hearing raises the big and important questions. Banks want to obey the law, but also grow their businesses. What happens when the two goals conflict? Banks want to know their customers, but some customers want privacy. How do we resolve this? As we write AML policy, we should look for ways to get all boats rowing in the same direction, letting banks and government each do what they do best as we all work to combat crime and terror.

At HSBC, we uncovered a number of troubling examples in which weak AML systems may have let criminal or terrorist funds pass through. In Mexico, for example, as the Chairman said, billions of U.S. dollars flowed from the HSBC affiliate in Mexico. The Mexico affiliate was the single largest exporter of U.S. dollars in Mexico to HBUS. U.S. law enforcement and the regulatory entities have concluded that because of the volume of money, it likely came from proceeds of the illegal drug trade—not a far assumption.

In another case, an Iranian bank was allowed to initiate U.S. dollar transactions that HSBC would process through the United States without explaining where they came from. At the time, however, there were severe legal restrictions on any payments coming from or going to Iran, most often meaning they would be manually inspected. HSBC's affiliate in London coached the Iranian bank on how to get the payments through the United States without inspection and simply requested the bank send transactions that would not violate U.S. law. In effect, it relied exclusively on an Iranian



bank to comply with a law intended to catch payments from Iranian banks. The bank or the officials that made the decision were either naive or willfully blind.

This is why tough AML laws are important. If illicit funds can be tracked and stopped, there are fewer places for criminals and terrorists to hide. And while our focus has been on the problems we found at HSBC Bank, we also have to emphasize that similar problems exist at other banks. For example, Citibank, Bank of America, Wachovia, Western Union, and others have come under scrutiny for laundering drug cartel profits.

The purpose of this hearing, then, is not just to make an example of HSBC as if it were an anomaly. Rather, this hearing is to help Congress understand what kind of risks this Nation faces and what we should do to reduce them. If we can get a better handle on the risks by looking closely at the operations of a single bank, we can write better laws and achieve our true goals: Stopping crime and preventing terror.

With that in mind, I believe there are several lessons we can learn from the problems that we uncovered at HSBC Bank.

First, banks around the world operate under different laws, creating different sensitivities to money laundering. While this seems apparent, it was not clear how much this would affect a bank with worldwide affiliates until we took a closer look. In the case of HSBC, its bank in the United States operated differently even than its own affiliates in London, Mexico, and the Middle East. Failure to recognize this can lull us into thinking we can rely on foreign banks to carry out U.S. law.

Second, bank regulators are sometimes better at identifying money-laundering vulnerabilities than knowing how to fix them. Throughout this inquiry, it became clear the Office of the Comptroller of the Currency was aware of many of HSBC's AML weaknesses, which it frequently pointed out. It was often at a loss, however, to prescribe how HSBC could eliminate the weaknesses. And so its record of enforcement at HSBC resembles a lapdog rather a watchdog that we sorely need.

We have also learned recently that investigators from Treasury's own Office of Inspector General have cited OCC personnel for unethical practices. This, unfortunately, does not seem to be an isolated incident, and we will go into greater detail in that as we see the facts unfold. Taken together with our Subcommittee's findings in this investigation, these conflicts are startling and suggest Congress should give closer scrutiny to the OCC's actions.

The purpose here is to stop criminals from hiding their illicit funds and preventing terrorists from having the freedom to plot and plan. The metrics we use to measure a bank's AML compliance need to focus less on form and more on substance. How well are we achieving our goal?

This Subcommittee has shown the kinds of vulnerabilities that we now face. Too often what we found left us very troubled, both for the risks to our Nation and for the level of effort we saw to eliminate them. HSBC made its share of mistakes, for which it is now being held accountable.

But what we must all remember is that money laundering always begins with a crime, and this ultimately is what we mean to

fight. To the extent that this hearing results in criminals and terrorists having fewer options to rob and harm the public, we will count it a success.

It may be impossible to stop all money laundering. Most of what we call money laundering in a certain context is a benign transaction in another. Buying travelers checks is innocent behavior for the tourist, but suspicious behavior when they are purchased in bulk by terrorists or drug lords. This does not mean we should not try to stop criminals from laundering their money through U.S. banks, but we need to do so wisely.

I appreciate the efforts that HSBC has made thus far to improve their AML systems, and I sincerely hope they stick. I look forward to hearing from their witnesses, as well as from the OCC, and appreciate their appearance before us today.

Thank you, Mr. Chairman.

Senator LEVIN. Thank you very much, Senator Coburn.

I would now like to call our first panel of witnesses for this morning's hearing: The Hon. David S. Cohen, the Under Secretary for Terrorism and Financial Intelligence at the U.S. Department of the Treasury; and Leigh Winchell, the Assistant Director for Investigative Programs at the U.S. Immigration and Customs Enforcement (ICE). I very much appreciate both of you being with us this morning. We look forward to your testimony.

Pursuant to our Rule VI, all witnesses who testify before the Subcommittee are required to be sworn, so at this time I would ask you both to please stand and raise your right hand. Do you swear that the testimony you are about to give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. COHEN. I do.

Mr. WINCHELL. I do.

Senator LEVIN. We will use a timing system today. About 1 minute before the red light comes on, you will see the lights change from green to yellow. That will give you an opportunity to conclude your remarks. Your written testimony, of course, will be printed in the record in its entirety, so please try to limit your oral testimony to 7 minutes.

Mr. Cohen, we are going to have you go first, followed by Mr. Winchell, and after we have heard your testimony, we will then turn to questions. Please proceed, Mr. Cohen.

**TESTIMONY OF HON. DAVID S. COHEN,<sup>1</sup> UNDER SECRETARY  
FOR TERRORISM AND FINANCIAL INTELLIGENCE, U.S. DE-  
PARTMENT OF THE TREASURY**

Mr. COHEN. Thank you, Chairman Levin and Senator Coburn. Thank you for inviting me to testify today. I am pleased to have the opportunity to discuss the importance of the Treasury Department's efforts to identify and combat money laundering and terrorist financing in the U.S. banking sector.

At the outset, it is important to recognize that the United States maintains one of the strongest and most effective anti-money laundering and counter-terrorist financing regimes in the world. This is

<sup>1</sup>The prepared statement of Mr. Cohen appears in the Appendix on page 94.

a testament to the work of the Congress, including this Subcommittee, the regulators, the enforcement agencies, and the financial institutions themselves. But the scale, efficiency, and sophistication of the United States' financial system—particularly its banking sector—make it a prime target for those who seek to conceal and move illicit money. This involves not just money launderers, of course, but also terrorists, weapon proliferators, drug lords, and organized crime figures, who all at some point rely on the financial system to store, move, and launder the funds supporting or derived from their operations.

Treasury's ability to protect the integrity of the U.S. financial system from abuse and to combat critical threats to our national security and foreign policy depends to a significant extent on the implementation by U.S. financial institutions of robust programs to prevent money laundering, terrorist financing, and sanctions evasion.

This morning I would like to briefly address why effective anti-money laundering, counter-terrorist financing, and sanctions compliance programs are so critical to our national security and the integrity of our financial system, as well as some of the steps we are taking, along with our partners in Congress, the Executive Branch, and internationally, to improve the effectiveness of our anti-money laundering, counter-terrorist financing, and sanctions compliance regime.

Although it is difficult to measure with precision, by any estimate, the total amount of dirty money moved through and concealed within the U.S. financial system is massive—in the hundreds of billions annually. The sheer volume of money moving through the banking system in particular makes banks both the most vulnerable financial institutions for money laundering and terrorist financing and the most important line of defense against money laundering and terrorist financing. Our regulatory framework, overseen by Treasury's Financial Crimes Enforcement Network (FinCEN), along with the Federal functional regulators, was built to require financial institutions to implement risk-based anti-money laundering programs, to collect and report useful information to law enforcement and national security authorities for the purpose of combating the full range of illicit finance. This regulatory framework assists banks in identifying and managing risk and creates the foundation of financial transparency required to apply targeted financial measures, such as sanctions against specific actors or prohibitions against specific activity.

To implement targeted financial sanctions, banks must screen clients and transactions against the Specially Designated Nationals (SDN) list, maintained by the Treasury's Office of Foreign Assets Control. This is a list of drug traffickers, weapons proliferators, terrorists, officials from rogue regimes, and other threats to our national security whose U.S. assets are frozen and who are generally forbidden from engaging in any transactions in the U.S. financial system.

Despite the importance of robust anti-money laundering and sanctions compliance programs, recent civil enforcement actions by OFAC, FinCEN, and the Federal banking regulators illustrate that sometimes financial institutions fail to implement adequate pro-

grams, exposing the U.S. financial system to significant risks of money laundering and resulting in illicit actors gaining access to the U.S. financial system.

We have seen, for example, an instance where a bank failed effectively to monitor its correspondent banking relationship with high-risk customers, resulting the processing of \$420 billion in cross-border financial transactions with 13 high-risk Mexican casas de cambio from 2004 to 2007. We have also seen several cases where foreign banks stripped out the names of Iran or other sanctioned entities in wire transaction messages routed through the United States, resulting in billions of dollars of benefits to sanctioned parties.

These and other similar cases have resulted in criminal fines and forfeitures of more than \$4.6 billion over the past 6 years. These cases raise important questions about vulnerabilities in the framework of anti-money laundering and counter-terrorist financing requirements that require immediate attention. As a result, Treasury is working closely with our interagency partners and the private sector to better understand the compliance challenges faced by financial institutions, clarify U.S. Government expectations of financial institutions, and strengthen the overall anti-money laundering and counter-terrorist financing regulatory structure.

In addition to continuing to impose sanctions on weapons proliferators, narcotics traffickers, transnational criminals, human rights abusers, and terrorist financiers, my office is also focused on improvements to our regulatory framework. One of our most important initiatives is to examine whether the customer due diligence rules, the foundation of financial transparency, should be improved.

Earlier this year, FinCEN issued an Advance Notice of Proposed Rulemaking suggesting ways to clarify, consolidate, and strengthen customer due diligence requirements for financial institutions, including an obligation to collect beneficial ownership information. We are also focused on combating the use of shell companies and other opaque legal structures that facilitate illicit financial activity. We strongly support legislation requiring disclosure of beneficial ownership information in the company formation process. And because strengthening anti-money laundering and counter-terrorist financing regimes internationally directly benefits the integrity of the U.S. financial system, my office works with others in the U.S. Government through the Financial Action Task Force, the International Monetary Fund, the World Bank, and the United Nations to encourage foreign jurisdictions to implement measures to combat illicit finance.

I began my testimony this morning by noting that the United States is home to one of the strongest anti-money laundering and counter-terrorist financing regimes in the world. In order to continue as the world leader in financial integrity, something we can and must do, we are obligated to push ourselves to identify where we can do better and to work tirelessly to get there. Today's hearing is one important step on this road, and I look forward to continuing to work with this Subcommittee to achieve this critical goal. Thank you.

Senator LEVIN. Thank you very much, Mr. Cohen. Mr. Winchell.

**TESTIMONY OF LEIGH H. WINCHELL,<sup>1</sup> ASSISTANT DIRECTOR  
FOR PROGRAMS, HOMELAND SECURITY INVESTIGATIONS,  
U.S. IMMIGRATION AND CUSTOMS ENFORCEMENT, U.S. DE-  
PARTMENT OF HOMELAND SECURITY**

Mr. WINCHELL. Good morning, Chairman Levin and Senator Coburn. Thank you for the opportunity to appear before you today and discuss the efforts of the U.S. Immigration and Customs Enforcement to combat transnational criminal organizations and the illicit proceeds used to fund their criminal activities.

Over the past two decades, transnational organized crime has transformed in size, scope, and impact, posing a significant threat to the national and international security. While the globalization of organized crime is not new, the magnitude, pace, and violence accompanying the illicit activities is alarming.

For example, in the past 5 years, we have seen an unprecedented level of drug-related violence south of our border which has claimed over 47,000 lives since 2006.

The fight against transnational organized crime is one of the highest priorities of ICE. With the most expansive investigative authority and the largest investigative force in the Department of Homeland Security (DHS), we work closely across agency and international boundaries with our law enforcement partners, creating a united front to disrupt and dismantle transnational criminal organizations. This is aided by our expansive global footprint. With a force of nearly 7,000 special agents assigned to more than 200 U.S. cities in 71 offices in 47 countries worldwide, our domestic and international network of agents all work in concert to target transnational crime.

One of the most effective methods of dismantling a transnational criminal organization is to attack the criminal proceeds that is the lifeblood of their operations. In fiscal year 2011, Homeland Security Investigation special agents initiated nearly 4,300 financial investigations, resulting in nearly 1,800 arrests, over 1,000 criminal convictions, more than 7,700 seizures worth approximately \$359 million, including \$331 million in currency and monetary instruments.

In 2010, ICE initiated a financial investigative project in the State of Arizona following an increase in cash activity at financial institutions along the U.S. and Mexican international border. As a result of recent changes in Mexican financial regulations, many criminal organizations were forced to explore new ways to exploit legitimate financial systems in order to launder their proceeds. A new trend emerged, known as the repatriation of the U.S. dollar, and coupled with the Mexican black market peso exchange, has led to an increase in identified U.S. currency along the southwest border region, in the last year and a half or so, approximately two-thirds of \$1 billion in the form of outbound international wires or cashier's check purchases from border branches of U.S. financial institutions, mostly to Mexico.

In 2005, ICE initiated Operation Firewall as an effort to raise worldwide awareness of the dangers posed by the cross-border movement and smuggling of illicit funds. Operation Firewall targets methods used to move and smuggle currency by focusing on

<sup>1</sup> The prepared statement of Mr. Winchell appears in the Appendix on page 99.

all aspects of illicit cash movements. Since its inception, Operation Firewall has resulted in more than 5,700 arrests, totaling more than \$553 million, and the arrest of 1,182 individuals. These efforts include 367 international seizures totaling nearly \$258 million and 253 international arrests.

In August 2009, ICE officially launched the National Bulk Cash Smuggling Center (BCSC) as a 24/7 investigative support and operations facility. Since its inception, the BCSC initiated over 500 criminal investigations, resulting in millions of dollars seized. The center has also provided training and outreach to over 21,000 Federal, State, and local law enforcement.

ICE's interaction with the financial institutions from an anti-money laundering perspective is multilayered. Through our Cornerstone Outreach Initiative, ICE HSI special agents share lessons learned, best practices, and money-laundering typologies with the AML personnel from financial institutions throughout the world. As part of these outreach efforts, special agents show how the bank systems and processes can and are being exploited. By sharing this information, the financial institutions are better able to understand the threats, inherent vulnerabilities, and build counter measures into their training and automatic monitoring systems. These outreach presentations take place at local branch bank locations as well as through speaking engagements at AML conferences such as those hosted by the Association of Certified Anti-Money Laundering Specialists (ACAMS).

In late 2009, HSI expanded their working relationship with the private sector through ACAMS to assist bank AML specialists to better identify and monitor financial activity related to non-traditional criminal groups. This expanded working relationship allows the members to learn more about current active financial indicators related to those crimes. The members can then incorporate what they have learned into creating models and filters within their AML software to more accurately identify financial transactions indicative of those crimes. The CAMS certification, obtained through ACAMS, is the most widely recognized AML certification among compliance professionals worldwide.

Since its inception, HSI special agents have conducted over 11,800 Cornerstone presentations and trained over 243,000 participants worldwide. This outreach has resulted in the initiation of over 447 criminal investigations, led to the arrest of approximately 330 individuals, 280 indictments, and over \$666 million seized.

Recognizing the magnitude of transnational organized crime, ICE will continue to work closely with our law enforcement partners as well as with the industry to identify potential vulnerabilities that could be exploited by terrorists and other criminal organizations to earn, move, and store their illicit proceeds.

I want to thank you again for the opportunity to appear before you today, and I would be pleased to answer any questions at this time.

Senator LEVIN. Thank you both. Let us start with a 7-minute first round.

Mr. Winchell, in your prepared testimony you talk about bulk cash, and we will be seeing a lot of discussion of that, about drug cartels smuggling U.S. dollars from the United States into Mexico,

finding a Mexican bank or a casa de cambio willing to accept the cash, after which the financial institution brings or tried to bring the dollars back to the United States.

Now, why would a drug cartel bother to smuggle U.S. dollars across the border into Mexico only to send those dollars or try to send those dollars back here again for deposit in our bank? Explain that circle. And why is it that process takes place? I tried in my opening statement to do it, but I would like to hear you try it also.

Mr. WINCHELL. The laws that were initiated in Mexico involving the banking industry set certain limits on the amount of U.S. currency that could go into banks in any particular period of time; \$7,000 for a business and \$4,000 per individual per month, I believe, are what the figures are. Bulk cash is moved south across the border as the proceeds of their illicit activity in the United States and pooled in Mexico. They are sold then to money brokers anywhere between 4 to 7 percent discounted rate. That may be casas de cambios and others that they use then to move in bulk cash back across the United States border into U.S. institutions and then wired back into Mexico and exchanged at the current rate between Mexican dollars and pesos, and in essence completing the laundering process of cleaning the money.

Senator LEVIN. But to put it simply, they cannot just directly deposit these drug sales money into U.S. banks because we have a Know Your Customer requirement. Is that correct?

Mr. WINCHELL. That would be correct, sir. They have to find someone in Mexico that would be complicit with their activity.

Senator LEVIN. But they want that money to be in U.S. banks, to get there and to be laundered.

Mr. WINCHELL. Yes, sir.

Senator LEVIN. So the short answer is they cannot do it directly, so they have to go through this process of sending it to a Mexican bank, if they can, and then having it returned cleansed. Is that correct?

Mr. WINCHELL. That is correct.

Senator LEVIN. Now, what is the relationship between the strength of a drug cartel and the ability of that drug cartel to launder money? Is it clear that the more it is able to launder its money, the stronger the cartel is?

Mr. WINCHELL. Their profits fuel their activity. The more profit they have, in other words, the more legitimate money they can appear to have, the more they can fuel their illicit activity and then diversify their criminal activity. So the larger the cartel, the richer the cartel, the more powerful they get.

Senator LEVIN. But also they will be more powerful if they can launder that money so that they can then diversify?

Mr. WINCHELL. Absolutely.

Senator LEVIN. All right. So that, again, we have all this huge violence on the border. We have drug cartels down in Mexico and drug groups here as well fighting for power, bringing violence to their streets and to our streets. And if they can successfully launder money, they are stronger. Is that accurate?

Mr. WINCHELL. That would be very accurate.

Senator LEVIN. OK. Mr. Cohen, would you agree that the more a terrorist can get their money through our system, the stronger a terrorist group will be?

Mr. COHEN. I would, Mr. Chairman.

Senator LEVIN. All right. Now, even though they have new rules down in Mexico, as you have just pointed out, I think starting in 2010, are illicit drug proceeds still being laundered into U.S. financial institutions, Mr. Cohen?

Mr. COHEN. I think there is no question that there continues to be a problem with money laundering in U.S. financial institutions coming from Mexico, from the casas de cambio and other institutions in Mexico, as well as from other sources where illicit proceeds are placed into the U.S. financial system.

Senator LEVIN. And, therefore, even though there have been changes in the laws, for instance, in Mexico and other efforts made to clamp down on the ability to launder money for these groups, the terrorist groups or drug cartels, it is still going on, and the efforts have continued. Can you give us some of the new efforts that are being made, the new challenges, Mr. Cohen, in this area of money laundering?

Mr. COHEN. Well, to pick up on what Mr. Winchell was discussing earlier, with respect to Mexico, obviously there is a substantial amount of legitimate trade with Mexico and a substantial amount of legitimate U.S. dollars that are spent in Mexico. And what we see is these Mexican financial institutions working with casas de cambio and then working with U.S. financial institutions to take in U.S. dollars from the Mexican economy. Dirty money is layered in with legitimate funds and placed into U.S. financial institutions. That continues to be a serious problem even after the really very important and aggressive steps that the Mexican Government has taken to restrict the ability of businesses and individuals to deposit U.S. dollars directly into Mexican financial institutions.

We have also seen some displacement of the money-laundering cycle, so instead of the drug dollars just moving into Mexico, because of the steps the Mexican Government has taken, we have seen some of these dollars move further south in coming back into the U.S. financial system from countries further into Central America.

Senator LEVIN. Now, when law enforcement or bank regulators see a bank in a country with drug-trafficking challenges transporting large volumes of U.S. dollars to the United States, is a red flag that illegal drug proceeds might be involved?

Mr. COHEN. I think financial institutions have in their anti-money laundering programs a whole series of factors that they look at to determine whether what is happening is normal, typical behavior or something out of the ordinary and whether it spikes in the amount of bulk cash coming in or other sort of anomalous activity. Those are the sorts of things that a well-tuned anti-money laundering program should identify and cause a financial institution to look at more carefully.

Senator LEVIN. OK. Senator Coburn.

Senator COBURN. Thank you.



Mr. Cohen, in your testimony, you stated that when safeguards are not stringently enforced, illicit actors are able to take advantage of the U.S. financial system. If they were all enforced 100 percent of the time, basically what I am hearing is they would still be able to take advantage of the U.S. financial system because when you blend good with bad from a legitimate organization—so what are the next steps to limit that down?

Mr. COHEN. Well, Senator Coburn, I would draw a distinction between the OFAC list, the SDN list, and anti-money laundering programs in responding to this question. A properly functioning compliance program with respect to the SDN list should prohibit anybody on that list from getting access to any U.S. financial institution because banks can run the filter, run the names, and if a transaction is coming through from someone who is on the SDN list, it should be stopped.

Preventing money laundering is a more difficult task, and the regulatory structure that we have implemented and that Congress has legislated through the Bank Secrecy Act and the PATRIOT Act and other amendments to Title 31 require a risk-based approach by financial institutions to have an anti-money laundering program that is appropriate given the risk that the bank faces across the range of its activities.

Every bank is going to approach this in a slightly different way, and every bank has a slightly different risk profile given its customer base domestically and how they interact with affiliates and non-affiliates overseas.

I do not think anyone expects to ever achieve a financial system where there is absolutely no money laundering, but it is also the case that when financial institutions do not implement robust anti-money laundering programs across the range of their activities that is appropriately tuned to the risk that they face, there is a greater opportunity for illicit acts to get access to—

Senator COBURN. So whose responsibility is it to see that the banks do just that?

Mr. COHEN. Well, I think it is all of our responsibility—

Senator COBURN. No, but it is specific to the Treasury, right?

Mr. COHEN. Sure.

Senator COBURN. It is the Treasury Department. Who in the Treasury Department is responsible for that? What agency?

Mr. COHEN. Well, my office is responsible for helping to set policy. We have obviously the OCC, which is part of the Treasury Department, that is a bank regulator. It undertakes its regulatory activities independently from the Secretary of the Treasury by statute.

Senator COBURN. Right.

Mr. COHEN. There are obviously other bank regulators as well that regulate other financial institutions.

Senator COBURN. But it is not necessarily that we do not have enough good regulations. Part of the problem is that the regulations we have are not being monitored and enforced properly. Would you agree with that statement?

Mr. COHEN. Senator, I think as we continue to work on the issue of money laundering, I think we need to look both at the regulatory structure itself and see whether there are modifications that would

be appropriate. And I also think we need to look at how effectively the regulators are overseeing financial institutions—

Senator COBURN. Well, I think we have seen that. Our investigation is going to show a lot of lack of effectiveness. As a matter of fact, it does show a lot of a lack of effectiveness. So the point I am trying to get to is we can write all the rules and regulations in the world, but if they, in fact, are not carried out by the bureaucracy assigned to do that, it does not matter. So the whole point is: Do we write a whole bunch more regs? Do we make it even more complicated?

One of the questions I had for you I am not going to ask. I will, if I may, Mr. Chairman, send supplemental questions to both of these witnesses. Of the people that are doing it right—and I am going to ask HSBC this, too. What is the cost of compliance with this as a percentage of the volume in their banks? And is there going to become a point at which it is not worth dealing with us? In other words, can we do it more effectively and more efficiently? And are we doing the right things?

Mr. COHEN. Well, Senator, I think we are looking at, as I said, whether the regulatory structure needs some modification, not to make it more complicated but to make it more effective. I think we are looking at whether the financial institutions themselves need to do a better job in complying with the regulations. And we are working very closely with the bank regulators across the spectrum of regulators, both bank regulators and the regulators in the securities industry, to talk about how we all can do a better job of overseeing compliance in the regulated industries.

Senator COBURN. Thank you.

Mr. Winchell, just one question. I am going to submit my questions for the record to both of you, if I might, and have you respond to them, hopefully in a timely fashion. You talked about your outreach efforts have resulted in the initiation of 950 criminal investigations. Did HSI agents identify the illicit funds or did the banks?

Mr. WINCHELL. It was usually the banks that—I would think I would be safe in answering that question. Our outreach efforts are an attempt to educate them on the red flags, and then they would bring those to our—

Senator COBURN. So you are getting some response?

Mr. WINCHELL. Yes, sir.

Senator COBURN. All right. And does your Trade Transparency Unit include partnerships with countries other than Central and South America?

Mr. WINCHELL. Our Trade Transparency Unit continues to grow.

Senator COBURN. But where is it now? Is it mainly Central and South America?

Mr. WINCHELL. It is primarily Central and South America, but it is expanding towards the Philippines and others, now.

Senator COBURN. And one thing I will ask you. Prepaid cards and stored value devices seems to be a new, novel method. I would love in the response to my questions from both of you on that, how are we going to handle that one? That one seems even more difficult.

Mr. WINCHELL. That one is a bit of a challenge for us; particularly as the individual crosses back and forth across the border in

bearer form, it is basically a bearer instrument. Of greater concern to us are the loadable and reloadable cards.

Senator COBURN. All right. Thank you, Mr. Chairman.

Senator LEVIN. Thank you very much, Senator Coburn.

I just have one more question. You touched on this in the answer to Senator Coburn's question. Just explain for us, if you would, Mr. Cohen, very simply, what the SDN list is, what the OFAC filter is, and how the OFAC filter relates to the SDN list and why these are important.

Mr. COHEN. Sure. The SDN list is the compilation of individuals and entities that have been subject to sanctions under the range of sanctions programs that OFAC and the Treasury Department implement. These sanctions programs cover illicit actors like terrorist financiers, weapons proliferators, transnational organized criminal groups, narcotics traffickers, as well as rogue regimes—Iran, North Korea, Syria, and others. Everybody who is subject to sanctions under those sanctions programs appears on the SDN list. This is a list that is published by OFAC, available to every financial institution, and by and large, financial institutions incorporate this list into their compliance programs and screen transactions coming through their financial institutions against this list, because everybody who appears on that list is forbidden from dealing with any U.S. person, including any U.S. financial institution, and their assets are to be frozen.

It is critically important that financial institutions run the OFAC list in their filters so that our sanctions programs are effectively implemented. We rely on financial institutions to ensure that those for whom we have applied sanctions are not able to access the U.S. financial system. That makes our sanctions programs, which at root are designed to pursue our most important national security and foreign policy objectives, as effective as they can be.

Senator LEVIN. How effective is the OFAC filter, in your judgment?

Mr. COHEN. There are some notable examples of situations where financial institutions have taken steps to try and evade the OFAC filter. We have over the course of the last 5 or 6 years entered into a number of significant settlements with major financial institutions that all have essentially the same fact pattern, which is that the foreign financial institution was stripping information from transaction messages running through the United States as a means to evade their U.S. partners' OFAC filter. Those are very important cases for us and I think illustrate how seriously we take this issue. But, at the same time, I think by and large, U.S. financial institutions do a good job of incorporating into their compliance programs the list of names and entities that are on the OFAC SDN list and screening transactions to prevent access to their institutions by those who are subject to sanctions.

Senator LEVIN. Will you put in your words now—I asked Mr. Winchell this before. Put in your words why it is that these entities we are trying to keep out of our financial system try to get into our financial system. Why is it that they make this effort, in your words?

Mr. COHEN. I think the simple answer is if you can run money through the United States, it helps to create an air of legitimacy

to those funds that makes it easier for you to then make use of those funds for whatever purpose you want to put them to. And if this is dirty money that you are trying to portray as clean funds, being able to run it try the U.S. financial system helps you achieve that objective.

Senator LEVIN. And makes you stronger.

Mr. COHEN. It helps you achieve whatever illicit objective it is that you are trying to achieve, whether it is weapons proliferation, terrorist financing, or any of the other activities that are the subject of our sanctions, all of which we are trying to combat by weakening their financial support.

Senator LEVIN. It helps you achieve the very activities that we are trying to stop.

Mr. COHEN. It does.

Senator LEVIN. Do you have any additional questions?

Senator COBURN. No, but I would make one observation. The better we get, the more they are going to want to be here. That is one. And number two is it is hard for us to know what an excellent anti-money laundering system is because we can always do better. But I would remind us that the cost of that is borne by the banks, which is ultimately the American consumer. And so efficiency in how we do this and the worry about too much—in other words, for the next regulation, what are we achieving for it? Cost-effectiveness has got to be part of our concern as we look to handle this.

Thank you, Mr. Chairman.

Senator LEVIN. Thank you very much, Senator Coburn.

There will be additional questions for the record for you both, and that will be true with all of our panelists this morning and afternoon. And talking about this afternoon, I think we have talked to your staff about it, Senator Coburn. The likelihood is that we will need to break at some point here for lunch. We will see how quickly the next panel goes.

We thank you both. We thank you and your agencies for the work that you do. It is critically important to our Nation's security, and you are excused.

Mr. COHEN. Thank you, Mr. Chairman.

Senator LEVIN. We will now call our second panel of witnesses for this morning's hearing: David Bagley, the head of Group Compliance of HSBC Holdings in London; Paul Thurston, Chief Executive for Retail Banking and Wealth Management at HSBC Holdings in Hong Kong; Michael Gallagher, the Former Executive Vice President and Head of PCM North America for HSBC Bank USA in New York; and, finally, Christopher Lok, the Former Head of Global Banknotes at HSBC Bank USA in New York.

We appreciate all of you being here this morning. We look forward to your testimony. And as you heard, we have Rule VI, which requires that all witnesses who testify before the Subcommittee are required to be sworn, so we would ask each of you to please stand and raise your right hand. Do you swear that the testimony that you are about to give will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. BAGLEY. I do.

Mr. THURSTON. I do.

Mr. GALLAGHER. I do.

Mr. LOK. I do.

Senator LEVIN. The timing system that we will be using today will give you a warning 1 minute before the red light comes on, and then it will shift from green to yellow. It will give you an opportunity to conclude your remarks. Your written testimony will be printed in the record in its entirety. Please try to limit your oral testimony to no more than 5 minutes each.

Before you start, I want to thank HSBC for their cooperation. As I said in my opening statement, HSBC was totally cooperative with this investigation. We appreciate that.

So, Mr. Bagley, I guess we are going to have you go first followed by Mr. Thurston, then Mr. Gallagher, and then Mr. Lok. And then we will turn to questions. So, Mr. Bagley, please proceed.

**TESTIMONY OF DAVID B. BAGLEY,<sup>1</sup> HEAD OF GROUP  
COMPLIANCE, HSBC HOLDINGS PLC, LONDON, ENGLAND**

Mr. BAGLEY. Thank you. Good morning, Chairman Levin, Senator Coburn, and Members of the Subcommittee. My name is David Bagley. Thank you for the opportunity to be here today. I have submitted written testimony, but in the interest of time, I have confined my remarks to a few points.

Since 2002, I have been the head of Group Compliance at HSBC Holdings plc, which is the global parent of HSBC. Having been a compliance officer for 13 years in a bank that operates in approximately 80 jurisdictions worldwide, I have dedicated my career—not only within HSBC but through my broader industry work as well—to meeting the significant challenges that confront global banking institutions in the world we live in. I have followed the work of this Subcommittee and have seen how your work has advanced important dialogues and helped the international banking community, including HSBC, identify and address potential vulnerabilities.

My chief focus as the head of Group Compliance at HSBC has been promoting the values that we, as a bank, have set for ourselves and the values that you and our regulators, both in the United States and around the world, rightly expect from a global bank like HSBC. And while there have been successes on many compliance issues, I recognize that there have been some significant areas of failure. I have said before and I will say again: Despite the best efforts and intentions of many dedicated professionals, HSBC has fallen short of our own expectations and the expectations of our regulators. This is something that a bank seeking to conduct business in the United States and globally must acknowledge, learn from, and, most importantly, take steps to avoid in the future.

The group has always had as a core element of its compliance policy a focus on both the letter and the spirit of laws and regulations, not just what is permissible but what is prudent and responsible.

In hindsight, as I reflect on the dialogue from 2002 to 2007, and specifically the wider lessons learned out of both the OFAC and Mexico issues, I think we all sometimes allowed a focus on what was lawful and compliant to obscure what should be best practices

<sup>1</sup> The prepared statement of Mr. Bagley appears in the Appendix on page 111.

for a global bank. Transparency is a principle that HSBC and every bank should always make a top priority, even when it is not legally required. I think that with our revised structure and approach, this is where we are today.

Indeed, we have learned a number of valuable lessons, and the bank is well along the way of converting those lessons into solutions. As I expect my colleague, Stuart Levey, to describe in some detail, HSBC is in the process of shedding the historical compliance model that the bank has outgrown. This departure from the old model is very significant. Our former compliance structure was a product of historical growth by acquisition, and it was a major factor behind some of the issues that I expect we will be discussing today.

Under the former model, my mandate was limited to advising, recommending, and reporting. My job was not to ensure that all of our global affiliates followed the group's compliance standards, and I did not have the authority, resources, support, or infrastructure to do so. Rather, final authority and decisionmaking rested with local line management in each of the bank's affiliates.

Now a major overhaul is underway. The new compliance model is a product of deep reflection and is tailored to address today's challenges as well as the inevitable challenges of tomorrow. Significantly, the Group Compliance function now for the first time has authority over the compliance departments at every one of the bank's affiliates. This is a stark break from the past. Now Group Compliance has both the mandate and the resources to ensure that affiliates are compliant. In other words, for the first time, Group Compliance is an advisory and a control function. In addition, personnel at the affiliates are now accountable to Group Compliance for their conduct.

Second, under the new model, Group Compliance oversees the bank's nearly 3,500 compliance officers worldwide and takes the lead on decisions about resource allocation, compensation, objectives, strategy, and accountability.

Last, while I do not have the time to describe all of the recent enhancements, I would like to emphasize the creation of our assurance function. In short, the authority of the head of Group Compliance and, therefore, the function as a whole is greatly increased.

As I have thought about the structural transformation of the bank's compliance function, I recommended to the group that now is the appropriate time, for me and for the bank, for someone new to serve as the head of Group Compliance. I have agreed to work with the bank's senior management towards an orderly transition of this important role.

Thank you for your time. I welcome this opportunity to answer any questions.

Senator LEVIN. Thank you very much, Mr. Bagley. Mr. Thurston.

**TESTIMONY OF PAUL THURSTON,<sup>1</sup> CHIEF EXECUTIVE, RETAIL BANKING AND WEALTH MANAGEMENT, HSBC HOLDINGS PLC, HONG KONG**

Mr. THURSTON. Thank you and good morning, Chairman Levin, Senator Coburn, and Members of the Subcommittee. My name is Paul Thurston. I am the Chief Executive of Retail Banking and Wealth Management for the HSBC Group. I have submitted written testimony, but in the interest of time today, I will confine my comments to a few points as well.

I have worked in the banking industry for 37 years, and I have served at various roles in HSBC around the world. I was the Chief Executive of HSBC for 14 challenging and stressful months beginning in February 2007.

When I arrived in Mexico, I set out to find out the most important business issues and risks that there were in the business. I met with business heads, risk management, audit, and also with the regulators, and it became clear that a number of group systems and policies had been put in place by that time but that this was not HSBC as I knew it. There were significant weaknesses in the control infrastructure, and these weaknesses existed in Know-Your-Client (KYC) and AML management and in other areas of the bank as well, including credit risk management, card fraud prevention, technology, and management information.

As I investigated these issues and tried to assess why the problems persisted, I came to learn that they were exacerbated by a business model and a performance management system that we had inherited from the former Bital Bank that was heavily focused on business growth rather than control.

I should add that we were operating in an external environment in Mexico that was incredibly challenging. Bank employees faced very real risks of being targeted for bribery, extortion, and kidnapping. And, indeed, there were many kidnappings during my tenure, and high levels of security were required for staff working in Mexico. In addition, unlike the United States, Mexico was a data-poor environment, making it difficult to verify the identity of customers.

Some of the things I found, frankly, took my breath away. But every time I found a weakness, I tried to ensure that we took action, not just in dealing with the immediate issues but also in setting up programs to improve the infrastructure, processes, and business model for the future. I frequently requested audit and group compliance reviews to be scheduled so that I would have an independent review of progress, and I kept the board, the regional audit committee, and group management informed of everything that I saw and did. And I also ensured that we cooperated fully with the regulators, as indeed the group has done with this investigation.

Effective AML depends upon properly knowing your customers, and this was a major area of concern to me, with substandard files and KYC documentation housed across a network of 1,300 branches. I committed to invest in technology and people, to centralize the review of all files for all new and existing accounts, and to keep central records that could be used for ongoing alert man-

<sup>1</sup> The prepared statement of Mr. Thurston appears in the Appendix on page 116.

agement. I recognized that this would take time to develop and install, but it would give us a more robust platform, provide more reliable reports, and improve the quality and speed of remediation once implemented.

I believe that we made real progress at HSBC Mexico during my short tenure. We changed the business model, the performance management systems, and we enhanced our compliance systems. But, clearly, after only a short period of time, there was still much work to be done upon my departure in April 2008, and the scale of the remediation work alongside an escalating drug war in Mexico and ever more adept criminals continued to raise challenges and new issues.

After I left, further steps continued to be taken. Decisions were made to stop U.S. dollar cash handling in Mexico. We closed branches in areas where there was a high risk of money laundering. We are now in the process of closing all the HSBC Mexico accounts in the Caymans. We will continue to scrutinize our business in Mexico to determine how we can further mitigate compliance risk.

We know that criminals operate globally, and as an international bank, we will be a target. We have to be sure that we have the best and strongest defense in place in every business, in every market in which we operate, regardless of the local challenges, and we are committed to doing this. We know we should have done this better, sooner.

There are many learnings in our experience in Mexico for us and others, and I will be pleased to answer any questions that you have.

Senator LEVIN. Thank you very much, Mr. Thurston. Mr. Gallagher.

**TESTIMONY OF MICHAEL GALLAGHER,<sup>1</sup> FORMER EXECUTIVE VICE PRESIDENT, HEAD OF PCM NORTH AMERICA, HSBC BANK USA, N.A., NEW YORK, NEW YORK**

Mr. GALLAGHER. Good morning. Chairman Levin, Senator Coburn, and Members of the Subcommittee, my name is Michael Gallagher, and I reside in Lincroft, New Jersey. From 2001 until last year, I was an Executive Vice President at HSBC Bank USA, also referred to as "HBUS," and I was responsible for the Payments and Cash Management Business in North America. On November 21, 2011, I was subject to a reduction in force at the bank and, therefore, have not been a member of the bank for the past 8 months.

During my time at HSBC, PCM developed and marketed payments and cash management services to corporate middle-market clients as well as financial institutions, including HSBC-affiliated banks. While PCM generally did not manage the various operational units within PCM processing PCM products, we worked very closely with our operations colleagues to manage and maintain the expected standards of quality and control.

I understand the Subcommittee is interested in HBUS's anti-money laundering efforts. During my tenure at HBUS, my team

<sup>1</sup> The prepared statement of Mr. Gallagher appears in the Appendix on page 124.



and I took compliance matters very seriously. We were active participants in the efforts of the compliance department to ensure safety and soundness. PCM assisted the compliance department operations as well as relationship managers in this regard. In instances, when PCM became aware of negative information regarding the client, PCM worked closely with the compliance department operations and the relationship managers to ensure that they received the information they needed.

PCM also made resources available to relationship managers and the compliance department to assist in any way that we could. At various times, PCM made staff available or seconded these staff to different departments to assist in various projects and problem resolution.

In summary, I would like to thank the Chairman of the Subcommittee for allowing me to speak at the hearing on these critical matters. Anti-money laundering, terrorism financing, and global access to the U.S. financial systems are issues of critical importance to the banking industry, to national security, and to me.

HSBC and the banking industry as a whole have learned many important lessons over the past decade or so. I believe that HSBC's experience, especially in light of its uniquely global footprint, can add real value to understanding more broadly the risks and opportunities for enhance safety in this industry.

During my time at HSBC, there were steps taken to tighten anti-money laundering controls, and I understand that significant progress has been made in this regard since my departure. But with hindsight, it is clear that we did not always fully understand the risks of our businesses or the challenges of the global, cross-border nature of the business. It is clear that we could have done much more and done it more quickly.

I appreciate the opportunity to provide this information to the Subcommittee, and I am prepared to answer any additional questions that the Subcommittee may have at this hearing. Thank you.

Senator LEVIN. Thank you very much, Mr. Gallagher. Mr. Lok.

**TESTIMONY OF CHIU HON "CHRISTOPHER" LOK,<sup>1</sup> FORMER  
HEAD OF GLOBAL BANKNOTES, HSBC BANK USA, N.A., NEW  
YORK, NEW YORK**

Mr. LOK. Good morning. Chairman Levin, Senator Coburn, and Members of the Subcommittee, I appreciate the opportunity to be here today. My name is Christopher Lok, and from 2001 until 2010 I served as the global head of the banknotes business at HSBC.

In my statement today, I will cover three topics. First, I will provide my background. Second, I will provide an overview of the banknotes business at HSBC. And, third, I will address some of the specific problems and issues that I believe the Subcommittee is interested in.

For me, it is painful and embarrassing to talk about the areas where, in hindsight, we fell short. At the same time, it is valuable to do so in order to find constructive solutions and so that others do not make the same mistakes going forward.

<sup>1</sup>The prepared statement of Mr. Lok appears in the Appendix on page 127.

I was born and raised in Hong Kong. In 1981, I started working in the banknotes business, and that is what I did for 29 years. During the entire time from 1981 through 2010, I worked for HSBC or a predecessor institution. For most of my career I was based in Asia, but I was privileged to have lived and worked in New York for a brief period in the 1990s and again from 2001 until 2010. Even though I am not a U.S. citizen, I had a wonderful experience living and working in this country, and I have a great admiration and affection for the United States.

I would like to provide a brief overview of the banknotes business. In essence, the business is about the buying and selling of physical currency at the wholesale level. Our clients were banks and other financial institutions around the world. We employed about 275 people, including traders, back office staff, and people who focused on operations and logistics. We dealt with approximately 800 customers in over 100 countries, and we transacted in about 75 different currencies. These customers have natural demand for and supply of currency banknotes, driven by various economic activities. To them, HSBC was a safe and reliable counterparty, and I believe that we provided them with a valuable service.

I understand that the Subcommittee is focused on some of the compliance challenges that we faced in the banknotes business.

Let me start by emphasizing that compliance was a critical part of the HSBC banknotes business. Over a period of years, there were some occasions when I communicated with my colleagues in compliance in a manner that was unnecessarily aggressive and harsh. These communications were unprofessional, and I deeply regret them.

In reality, the business line and compliance shared the same objective: To avoid the bank being used by inappropriate people for improper transactions. Despite my overly critical emails, I believe banknotes business and compliance people actually had a good working partnership. While I did not always communicate this, I had great respect for my colleagues in compliance, and I valued their work.

With respect to banknotes transactions with customers in Mexico, up until December 2008 I was under the impression that HSBC's Mexican affiliate, HBMX, was operating under HSBC group standards. In December 2008, HBMX announced that it would no longer be accepting U.S. currency in Mexico. I was surprised by this announcement, and I tried to find out what was the reason behind it. It was not until early 2009 that I learned, as a result of my own inquiries, that HBMX had gotten into problems because their anti-money laundering controls were seriously compromised. I was surprised and concerned about this news. I was not previously aware of the AML problems at HBMX. If we had known of these problems, I am certain that we, in the banknotes business, would have done things differently.

As time went by, some questions were raised about the banknotes business in Mexico. In retrospect, we did not adequately appreciate the concerns being raised about the business environment in Mexico. While we did our best to deal with these inquiries, I am sorry to say that I did not understand what later became apparent.

With the benefit of hindsight, it is now clear that we did not perceive the extent of the anti-money laundering deficiencies and the risks present in Mexico. Thank you very much.

Senator LEVIN. Thank you very much, Mr. Lok.

Let us have a 10-minute first round, if that is all right. Does that give you enough time?

Senator COBURN. Yes.

Senator LEVIN. Because we will have more than one round.

Mr. Thurston, HBMX was a bank that had a longstanding severe money-laundering problem, and we describe this at length in our report. The bank was purchased in 2002. You did not arrive until 2007. Take a look, if you would, at the exhibit book, Mr. Thurston, in front of you there, Exhibit 1b.<sup>1</sup> What we have done here is we have put together a chart summarizing some of the exhibits. Just a few highlights from those exhibits, which are really a litany of money-laundering deficiencies at HBMX from 2002 to 2009.

The first reference is to 2002 in this exhibit. Here is what the audit found: "There is no recognizable compliance or money laundering function" at Bital. That is the bank that you bought. That is 2002.

Then in 2005, 3 years later now, "senior persons within the compliance function fabricated records of certain mandatory anti-money laundering meetings." This quote is taken from Exhibit 12,<sup>2</sup> but we put together these quotes on this Exhibit 1b.

Now, the fabrications were ordered by the head of the anti-money laundering compliance program who was asked then to leave the bank. This email was sent by Mr. Bagley to Stephen Green, who was then CEO of the HSBC Group.

Next, 2007. This is a quote from a July 7, 2007, email from a senior compliance person at HSBC Group, John Root. It is taken from Exhibit 19.<sup>3</sup> It is an email to the head of HBMX compliance after finding out that the anti-money laundering committee allowed three different high-risk accounts with suspected illegal drug proceeds to stay open, and he writes, "What is this, the School of Low Expectations banking?"

Then in 2008, this is a statement from HBMX's own AML director who was leaving that Mexican affiliate, and he was participating in an exit interview with Mr. Bagley, and he said the following: That there were allegations of 60 percent to 70 percent of laundered proceeds in Mexico going through HBMX. He also stated that HBMX executives did not care about AML controls. That comes from Exhibit 30.<sup>4</sup> This is 2008.

And then another quote from Mr. Bagley in 2008: "What I find most frustrating is the way in which new issues constantly emerged, however much time is spent with HBMX."

In 2009, a statement from an email from Mr. Bagley to the CEO of HSBC Latin America, Mr. Alonso: "The inherent anti-money laundering risk in Mexico is still very high."

So this had been going on for 7 years, money-laundering problems at the HBMX bank, the Mexican affiliate.

<sup>1</sup> See Exhibit No. 1b, which appears in the Appendix on page 576.

<sup>2</sup> See Exhibit No. 12, which appears in the Appendix on page 634.

<sup>3</sup> See Exhibit No. 19, which appears in the Appendix on page 673.

<sup>4</sup> See Exhibit No. 30, which appears in the Appendix on page 703.

So, Mr. Thurston, when you arrived in 2008, you began immediately making some changes. The problems that you faced had been longstanding. They were not corrected before you got there, and some of them, plenty of them, were not corrected until you got there, and then some remained and they were corrected, some of them, after you left.

Why did you discover that these had festered for so many years? What was there about that bank, that culture that you discovered that allowed these things to go on and on and on? These are not thing which were discovered later. These were known at the time. Emails show that they were known at the time. A number of you have talked about hindsight. These are contemporaneous emails. This is not something discovered in hindsight or learned in hindsight. This is something that people knew was going on at that bank. Why was it allowed to continue? What did you find when you got there?

Mr. THURSTON. Thank you, Mr. Chairman. My assessment was that starting from before the acquisition, this bank had been a fast-growth bank. In fact, that was the reason why it got into trouble, and that was the reason that we were able to acquire it. It grew fast, but it had no controls. The business model was completely decentralized. All the files, all the decisions were taken in a distributed branch network. It was very difficult from the center to get controls, and there was a very strong incentive scheme that backed continued volume growth rather than quality of controls.

A number of steps were taken to install group processes and group systems, but if you are confronted with that, as I said in my opening remarks, you need to address the business model that is underneath it and put something systemic in. So one of the steps that I took was to create this centralized platform where, instead of relying on 1,300 branches to do the KYC, we would have all of those papers imaged to a central site where we could check and see that we had all the documents, that we had all the papers, and if we did not, then we would not open the accounts.

But that kind of investment takes time, and there was a significant remediation task to be done to put right the files from the past. So there were multiple problems that existed in the bank, as I saw it when I was there.

Senator LEVIN. These were problems which were known for years. This is not something which was looking back. This is something which year after year after year, starting in 2002, was known by this bank. And yet these problems festered for years.

Here is another email, Exhibit 36.<sup>1</sup> This was an HSBC Group deputy head of compliance, a 2008 email. Now, he had been sent to Mexico to try to get a handle on money-laundering problems there. One of the problems discussed was a backlog of 3,600 accounts that were supposed to be closed but were not, including 675 which had been identified as potentially involving money laundering that had been ordered closed by HBMX's anti-money laundering committee, known as CCC, or Triple C. Here is what the email noted, and this is Exhibit 36: That of the 675 accounts, 16

<sup>1</sup> See Exhibit No. 36, which appears in the Appendix on page 726.

had been ordered closed in 2005, 130 in 2006, 172 in 2007, 309 in 2008. So it took 3 or 4 years to close a suspicious account.

Now, is there any way that should have been allowed to have happened at the time? Forget the business case and anything else.

Mr. THURSTON. No, Senator.

Senator LEVIN. Now, another problem involving HBMX was the committee at the bank which was mandated under Mexican law and is composed of both business and compliance personnel charged with resolving anti-money laundering issues, such as what accounts should be closed.

In July 2008, after the CCC committee decided to allow several suspect accounts to remain open, a senior compliance official at HSBC Group, John Root—so now this is the group now—sends a blistering letter to HBMX compliance head, Mr. Garcia, at Exhibit 19.<sup>1</sup> I am going to read from this exhibit. “A number of items jump out from your most recent weekly report . . . but everything pales in comparison with the [money-laundering] items on page 4,” he writes. “It looks like the business is still retaining unacceptable risks and the AML committee is going along after some initial hemming and hawing. I am quite concerned that the committee is not functioning properly. Alarmed, even. I am close to picking up the phone to your CEO.”

“What on earth is an ‘assumption responsibility letter’ and how would it protect the bank if the client is a money launderer? Please note,” he writes, “that you can dress up the USD 10 million to be paid . . . to the U.S. authorities as an ‘economic penalty’ if you wish but a fine is a fine is a fine, and a hefty one at that. What is this, the School of Low Expectations Banking? (‘We didn’t go to jail! We merely signed a settlement with the Feds for \$10 million!’)”

“So,” he said, one problem was “strike one.” Another is “strike two. Let’s now look at strike three,” he writes. “(I hope you like baseball.)”

“The same person who is giving”—this is his writing—“the sacrosanct ‘assumption responsibility letter’ . . . is being asked by the CEO to explain why he retained Casa de Cambio Puebla relationship after USD 11 million was seized by the authorities in Puebla in an account with Wachovia in Miami. What?! The business was OK with this?”

And then he says, “The [anti-money laundering] committee just can’t keep rubber-stamping unacceptable risks merely because someone on the business side writes a nice letter. It needs to take a firmer stand. It needs some cojones. We have seen this movie before, and it ends badly.”

Why is it that the bank—the bank that is the group bank—that sees these kind of problems just does not flat out hold some folks accountable and fire some folks? I mean, they can write this kind of a letter, and they did, and we dug this out of the emails. Why, if the folks running this bank are so bad, why isn’t action taken against them by the parent bank?

Mr. THURSTON. Mr. Chairman, in the time that I was in Mexico, we were very firm on discipline. We took strict disciplinary action

<sup>1</sup> See Exhibit No. 19, which appears in the Appendix on page 673.

against many members of staff, even at senior management levels, including dismissals. So we were certainly taking it seriously within Mexico.

Senator LEVIN. My time is up. Thank you. Senator Coburn.

Senator COBURN. I want to go to Mr. Bagley for a moment, if I might. I think your testimony was that you were in charge of compliance, but you had no essential line authority to enforce that compliance. Is that correct?

Mr. BAGLEY. That is right. The core responsibility of Group Compliance was to set policy, to report, to escalate issues when they were reported to us, but we did not manage and control the individual compliance departments in each one of the affiliates or subsidiaries.

Senator COBURN. Those individual compliance departments in those subsidiaries reported to the head of whatever that subsidiary was, correct?

Mr. BAGLEY. There were two reporting lines: One to the Group Compliance team for reporting and other reasons, and then another line to the local CEO or business head.

Senator COBURN. And I think it was also your testimony that had now been changed and that there is a line function for compliance from corporate HSBC all the way down to every bank. Is that correct?

Mr. BAGLEY. It has fundamentally changed in that the hardest line of reporting is now through the function, so I am accountable, responsible, and have authority over the whole function globally, 3,500 people across the group, and that means I control resource, allocation, budget, remuneration, the performance and the function, and can ensure that the adequate resources, the right amount of money is spent on this effort. It is a radical shift, a significant change.

Senator COBURN. There is the answer to the question you asked. In other words, there is no line authority—you can have a compliance officer all you want. If they have no line authority to cause people to change actions and the same people they are guiding have a line authority that says here is your profit, how well our affiliate or our subsidiary does, one of those is going to have more power than the other. Thank you.

Mr. Gallagher, you said in your testimony, “But with hindsight, it is clear that we did not always fully understand the risks of our businesses” and “that we could have done much more and done it more quickly.”

Looking at the whole of this, that to me is almost an unbelievable statement when you have things going on in Mexico, things going on elsewhere. It is almost like you were not aware that these things were happening?

Mr. GALLAGHER. It is a fact that there are certain things that we were not aware were happening. Within certain entities that is true.

Senator COBURN. What were the efforts made to try to become aware of what was happening? My natural inclination is to say you were not—did not fully understand the risk or you ignored reality, based on the testimony and the data that we have collected from

inside your own operations. Would you just expand on that a little bit so I can gain a clearer understanding?

Mr. GALLAGHER. Yes, I appreciate the question, and I share your concern on this matter. One of the lessons we have certainly learned is the sharing of information not only throughout the organization across various operations and silos, as it were, but across geography is something that requires significant improvement. I am led to believe that has improved significantly since I left, and even during my time there, there was improvement in the process. But heretofore it was not easy to move information across organizations and to filter it down to the appropriate levels to get action.

Compliance and monitoring was our first level of finding issues and looking after them, and whenever we found issues, in my experience, I believe we inquired, we reacted, and we pursued. So I think we did a lot at the time, but as has been said by others this morning, we have learned a lot as we have gone along.

Senator COBURN. OK. Thank you.

Mr. Thurston, in early 2007, right when you started, one of HBMX's clients was Zhenli Ye Gon, a reported drug lord who got caught selling precursor chemicals for methamphetamine production for La Familia and the Sinaloa cartels. When you learned that Mr. Ye Gon was a client of HBMX, what was your reaction? What did you do?

Mr. THURSTON. Well, I was horrified by the case, and this really exposed a whole series of weaknesses within the bank. So I personally conducted an investigation. I brought in the audit team. I brought in the security and fraud team. I brought in the compliance team. And we made a number of changes. This is where I found, for example, the business heads were overriding the people in the Compliance Department on decisions on accounts. So I put up an escalation process so that Compliance had a route to the chief operating officer and then to me if they were not comfortable with the decisions that were being made through that legal committee.

I looked at the fact that we had here a business account that was being managed in the personal consumer part of the bank, which would make it very hard for people then to spot the underlying activity and compare it with normal activity. So we made a number of changes about that, and that is where we started to—we dismissed a number of people who had falsified visit records, not been to visit the premises when they said they had. That is when I realized that practice existed.

We looked to see if there was any sign whatsoever of any collusion. We investigated all the staff's accounts. And as a result of that, we found some incidents of staff lending to each other, so we created policies on that.

So there were a whole series of actions that stemmed out of finding that incident.

Senator COBURN. There was, in fact, significant attention from the compliance officer at that time, correct? Prior to your knowledge of it, that had been raised as an issue.

Mr. THURSTON. That is correct, Senator Coburn.

Senator COBURN. All right. Thank you.

During your tenure at HBMX, I understand that law enforcement in Mexico raised concerns about high-risk money laundering at HBMX. Why was it that the Mexican legal authorities think now today that your record was worse than any other bank in Mexico? Is it a fact or is there some assumptions there that the Subcommittee should know about?

Mr. THURSTON. They found that whenever they wanted information from the banks, HSBC was one of the slowest to respond. So when they were conducting investigations, HSBC took longer to produce documents and had more challenges producing documents than most of the other banks. When we investigated that, again, we looked to see if this collusion, is this people deliberately trying to hold information from the authorities, and we found no sign of that whatsoever. But what we did find was a process where these things would go out to branches. Because all the files were held out in all the branches around the country and the quality was so poor, it would take a long time to collate effective information and get it back, and there were things that were missing, which is why the centralized program we had was so important. But we were also swamped with information requests. We had on average 1,000 a week coming from the regulators, not distinguishing between different types.

So we then set up a direct line with the financial intelligence unit within Mexico so that where they were conducting urgent investigations, they could come through straight to the bank so that we could respond more quickly.

Senator COBURN. OK. Thank you. I will yield back for right now.

Senator LEVIN. Thank you.

Mr. Thurston, you were at the bank there for a year, you have testified, and while there, you made some improvements. But the problems continued, and part of the reason was the nature of high-risk products and clients that the bank had, and I want to get to some of that issue by discussing with you the Cayman accounts.

Now, when you bought the Mexican bank, when HSBC bought the Mexican bank, it found that HBMX kept open a so-called branch office in the Cayman Islands. Now, I say "so-called branch office" because my understanding is there was no actual building, no office, no employees. It was just a shell operation that offered U.S. dollar accounts.

The branch, so-called, in the Caymans was run by HBMX itself using its own employees in Mexico. Any HBMX branch could open a U.S. dollar account for a client, and at one point 50,000 clients had these Cayman accounts, holding \$2.1 billion in assets.

Now, we have spent a lot of time on this Subcommittee raising questions about Caymans and other tax havens for tax avoidance purposes, but this is a little bit different, and this Subcommittee has a lot of interest in these issues involving the Caymans because they are shell corporations, and they pose significant money-laundering problems, and they do it as soon as they are organized because nobody knows who is behind those corporations. And here are a few of the highlights relative to the Caymans.



Exhibit 9<sup>1</sup> is a 2002 audit of HBMX, and that audit notes that 41 percent of the accounts in the Cayman Islands had no client information.

Exhibit 31<sup>2</sup> is a 2008 email by Mr. Root saying that “15 percent of the customers there did not even have a file.”

“Fixing the Cayman accounts will be a huge struggle.” He says, “How do you locate clients when there is no file?”

Exhibit 32<sup>3</sup> is a July 2008 email noting that HBMX has discovered “significant U.S. dollar remittances being made by a number of HBMX Cayman customers to a U.S. company alleged to be involved in the supply of aircraft to drug cartels.”

A later email, November 2008, which is Exhibit 34,<sup>4</sup> describes the Cayman accounts as having been frozen “due to massive misuse of them by organized crime.”

So, Mr. Thurston, first of all, did you know that the Cayman branch was fictitious, just a shell?

Mr. THURSTON. It is what is called a cat B license, I believe.

Senator LEVIN. But did you know that it was just a shell company? There were no employees there, no office there. Were you aware of that?

Mr. THURSTON. I know now, sir.

Senator LEVIN. And did you know about the problems at the Cayman accounts that I have just read?

Mr. THURSTON. Mr. Chairman, no, I did not during the time that I was there, and on reading your report, I was really angry to find there had been an audit report on these in the previous year, but that it had been closed off with no action. So when I got there and went through what are the top risks and the big audit outstanding items, these were nowhere to be seen.

Senator LEVIN. All right. So you were unaware of the Cayman accounts at the time that you were head of that office?

Mr. THURSTON. Correct, sir.

Senator LEVIN. Now, Mr. Bagley, you indicated to the Subcommittee during an interview that although you were aware of the accounts since 2002, the Cayman accounts, you focused on them only after a July 2008 incident involving funds going to buy planes for drug cartels. Now, I do not know, given the history here, how you could possibly not know of the severity of the problems involving the Caymans until that time, but in any event, after that incident, the new head of HBMX decided—and this is, I think, 2008 now—Mr. Pena decided to suspend opening new Cayman Island accounts.

So under Mr. Pena, HBMX initiated a review of the accounts, eventually closed 9,000 of them. But as of the beginning of 2012, there were still about 20,000 accounts with \$670 million in assets. So two-thirds of the money-laundering risk continues.

So, Mr. Bagley, this Subcommittee really has found out that these kind of shell corporations in the Caymans and other places create all kinds of tax avoidance problems, but this is a different kind of an issue here. This is a money-laundering issue, and we

<sup>1</sup> See Exhibit No. 9, which appears in the Appendix on page 607.

<sup>2</sup> See Exhibit No. 31, which appears in the Appendix on page 708.

<sup>3</sup> See Exhibit No. 32, which appears in the Appendix on page 711.

<sup>4</sup> See Exhibit No. 34, which appears in the Appendix on page 720.

have now two-thirds of those accounts which were in the Caymans, with that many assets apparently still sitting there. What are you going to do about it?

Mr. BAGLEY. Thank you. The point is that when we became aware of those Cayman accounts, the ones that remain have all been fully remediated. So when we became aware and focused on the Cayman accounts themselves, what we did as a group, what HBMX did was work through each and every one of those accounts, revised and refreshed the KYC to satisfy ourselves that there was an explanation for the monies and that we were satisfied with the source of the funds. And, therefore, what is left has been subject to revised and enhanced due diligence and a refreshment of all of the information that we are holding.

Senator LEVIN. Does that mean 20,000 accounts now that you are going to keep there?

Mr. BAGLEY. Well, actually, the group has recently arrived at a decision, which I support, which is to actually close all of those Cayman accounts.

Senator LEVIN. "No." Well, that is the short answer, a very welcome answer, and particularly I think this Subcommittee can really look at its work as contributing to this kind of pressure on you to do the right thing.

Mr. BAGLEY. Sorry to interrupt. I should just be very clear that we are in the process of closing those accounts. They are not yet closed, but they will all be closed.

Senator LEVIN. That is good news.

Now, HBMX did not inform HBUS about the Cayman U.S. dollar accounts for many years. Is that correct, Mr. Gallagher?

Mr. GALLAGHER. Yes, sir, that is correct.

Senator LEVIN. So these transactions were run through the U.S. dollar correspondent account that HBMX had at HBUS. Would HBUS have wanted to know about these high-risk accounts in a secrecy jurisdiction? Would you have wanted to know that?

Mr. GALLAGHER. Absolutely.

Senator LEVIN. Do you know why you were not informed?

Mr. GALLAGHER. No, sir, I cannot answer that question.

Senator LEVIN. Maybe Mr. Bagley or Mr. Thurston. Why wouldn't HBUS have been informed of those accounts?

Mr. BAGLEY. It is a very appropriate question. I think there are two or three reasons. One is that at that stage neither HBUS, as your report reflects, was conducting affiliate due diligence. Second, we at that time did not do affiliate due diligence across the rest of the group. And as a consequence, the questions that you would normally expect to be asked by one affiliate of another, one correspondent bank of another, were not asked. They are now.

Senator LEVIN. Under your new rules now, you are going to be notifying each of the affiliates of this kind of action?

Mr. BAGLEY. What we are doing and have introduced and are in the process of rolling out is affiliate due diligence across the whole group, so every affiliate will do due diligence on its own affiliates. That will be to the same standard as we apply to an entirely independent third party.

In addition, we have put in place a process that ensures that if there is a material AML deficiency or issue or risk in one affiliate,

that will be reported on a mandatory basis across the group and will automatically go to the head of compliance for each region. So what that will mean, when that work is complete, is that each affiliate will treat its affiliates at arm's length, will ask all of the appropriate questions, will know everything that it needs to know about the risk profile that one affiliate presents to another.

Senator LEVIN. And when will this be put in place? You said it is being put in place. When will this be accomplished?

Mr. BAGLEY. We are rolling out—it will take a while, obviously, to complete those due diligence profiles. We will use the ones we have already completed for the United States in response to the cease and desist orders. We will do it as fast as we can. We have already put in place the mandatory reporting of AML deficiencies, and we have that up and running as a process.

Senator LEVIN. When will it be completed, do you know?

Mr. BAGLEY. I do not know exactly when it will be completed, but we will do the highest risk as quickly as we can.

Senator LEVIN. All right. Will you let the Subcommittee know when it is completed?

Mr. BAGLEY. I would be very happy to.

Senator LEVIN. Thank you very much. Senator Coburn.

Senator COBURN. Mr. Gallagher, if you would turn to Exhibit 40.<sup>1</sup> The Bank Melli in Iran, prior to September 11, 2001, HSBC had a relationship with this bank in Iran which, because of its home country, would get more scrutiny in the United States. HSBC in Europe helped coach Bank Melli to send payments through the United States without getting slowed down.

Why was HSBC interested in doing business with this bank?

Mr. GALLAGHER. I cannot speak specifically for all of the reasons. The business desire was coming out of Europe and the Middle East, not coming out of the United States. There was a memo that described some opportunities that they saw for growth in business generally, but HBUS was not driving that business decision.

Senator COBURN. What was it exactly that made you say in this email, "I wish to be on the record as not comfortable with this piece of business"?

Mr. GALLAGHER. Yes, thank you. That is a very important question. I was very concerned about the lack of transparency in the proposal that had been put forward that described how the payments would flow. So in this particular case, there seemed to be an inability for the bank—that is to say, Melli—to describe in advance who its primary beneficiaries would be. That caused me to say we should not want to engage in business with a client who cannot provide that level of transparency to our system.

Senator COBURN. So there was really no Know Your Customer here?

Mr. GALLAGHER. I cannot speak to that because Know Your Customer would have been done on the European side. But when I became aware that there was seemingly a lack of transparency in one of my roles, I thought that was inappropriate and very strongly suggested we should not proceed.

Senator COBURN. And so what was the response to that?

<sup>1</sup> See Exhibit No. 40, which appears in the Appendix on page 755.

Mr. GALLAGHER. Well, ultimately the transaction never was approved.

Senator COBURN. And do you know why?

Mr. GALLAGHER. Discussion went on for some time back and forth across the regions and the world. I do not recall the specific reason, but I was delighted to know that my recommendation was part of the solution.

Senator COBURN. Did you raise other concerns other than in this email that we have documented under Exhibit 40?<sup>1</sup>

Mr. GALLAGHER. About Bank Melli specifically?

Senator COBURN. Yes.

Mr. GALLAGHER. I do not recall.

Senator COBURN. OK. If you would turn to Exhibit 57,<sup>2</sup> Iranian U-turn payments, in November 2004. This email suggests that some inside HSBC thought that all Iranian payments through the United States should be fully disclosed. Nonetheless, many payments still went through without full transparency, sometimes because information was removed by HBEU. This email says, "HBEU would be advised to not alter the payment details in any way."

Was it well understood within HSBC that information was being removed from payments before they arrived in the United States?

Mr. GALLAGHER. I do not know how well understood it was, and I do not recall specifically some of these exchanges. But if I had to speculate, consistent with my earlier position, which was unchanged, regarding the importance of transparency in these messages, I am quite comfortable that the proper people were alerted and it was in the proper hands for resolution. But specific details on this I do not recall.

Senator COBURN. But the decision went really against your advice?

Mr. GALLAGHER. Yes.

Senator COBURN. Because, in fact, they were altered, correct?

Mr. GALLAGHER. It would seem so, yes.

Senator COBURN. OK. Do you have any idea how HSBC intended to make sure all these payments complied with U.S. law?

Mr. GALLAGHER. There was a view at the time that the team in London and/or subsequently elsewhere was going to ensure that the payments were going to be U-turn compliant before they got to the United States.

Senator COBURN. Do you think they were?

Mr. GALLAGHER. I do not honestly know specifically that they were not. Some of this information is slightly new to me in being involved in this investigation and catching up. So I do not know the specific answer to that question.

Senator COBURN. Who would know the answer to that question?

Mr. GALLAGHER. I would suggest either operational staff doing the work on the other side and/or possibly somebody in Compliance.

Senator COBURN. Should they have relied on people in Iran to do that?

<sup>1</sup> See Exhibit No. 40, which appears in the Appendix on page 755.

<sup>2</sup> See Exhibit No. 57, which appears in the Appendix on page 844.

Mr. GALLAGHER. No. Certainly, in retrospect, we should not have relied on anybody but ourselves to ensure the soundness of the payments coming into our system.

Senator COBURN. Mr. Lok, in your testimony, you said compliance was a critical part of the HSBC banknotes business.

Mr. LOK. Correct, sir.

Senator COBURN. Can you explain to me exactly what you mean by this? And tell me what it looked like.

Mr. LOK. We have a system in place whereby customers are risk-rated, and they are rated according to different categories, and then, therefore, the high-risk customers, we need to make sure that there is a process in place whereby the information about a client is laid out in the open so that people can come in, including the relationship managers, the business people, as well as compliance, so that we can evaluate the risk. And, finally, compliance has to be the final sign-off so that we can do business with these people. In other words, we consider compliance a very important partner in our business.

Senator COBURN. Did you recognize certain vulnerabilities in your compliance strategy in the banknote business?

Mr. LOK. At that moment, honestly, no.

Senator COBURN. You would agree that there were, though, in hindsight?

Mr. LOK. In hindsight, yes. Looking at all these documents, yes. The answer is definitely yes.

Senator COBURN. Just for our educational purposes and given your broad experience, are there certain challenges that are different in the banknote business related to specific currencies over other currencies?

Mr. LOK. I am sorry. Can you repeat the question?

Senator COBURN. Are there specific challenges in the banknote business in terms of compliance related to one currency over another, not necessarily in terms of geographic location, but, for example, is it easier to run a scam or play the game with the U.S. dollar, the British pound, the euro, the Japanese yen, the renminbi? In other words, does the same compliance vulnerabilities that you see now in hindsight apply differently to different currencies and different geographic locations?

Mr. LOK. At that moment, no, it did not strike me that there is a difference in terms of compliance risk because the policy itself spells out exactly how we run it, analyzing the risk. No, we were not—no. The answer is no.

Senator COBURN. All right. I will yield back.

Senator LEVIN. Let me ask some questions about the Sigue Corporation, which was a U.S. money service business that transmitted funds from U.S. clients to Mexico and Latin America. The Drug Enforcement Association undertook a sting operation in 2007 in which its agents told Sigue's operators that they wanted to send drug proceeds to Mexico, and more than two dozen of those Sigue operators obliged.

In January 2008, Sigue entered into a deferred prosecution agreement with the U.S. Department of Justice, admitting the facts, for failing to have adequate money-laundering programs. HBUS determined that in 2007 alone it had processed 159 U.S. dol-

lar wire transfers for Sigue involving about half a billion dollars, and they were all sent through the HBMX correspondent account with HBUS.

Then if you would look at Exhibit 18a,<sup>1</sup> Mr. Gallagher, this was a memo that was prepared by HBUS after a 2008 *Wall Street Journal* article on the Wachovia case. It talks about the Sigue case and its use of the HBMX account, but it also notes that Sigue was not added to the HBUS filter so that it could be subjected to enhanced anti-money laundering to identify suspicious activity.

Now, you were the head of PCM at that time, Mr. Gallagher, and that handles wire monitoring. Do you know why HBUS did not subject Sigue to enhanced monitoring after the 2008 deferred prosecution agreement?

Mr. GALLAGHER. No, Mr. Chairman, I do not know. Looking at the memo, I note that I am not addressed on the memo. I cannot honestly recall if I saw the memo. But the decision as to whether or not to add any name to enhanced monitoring or to a filter, etc., is a decision that would be taken in Compliance, not in PCM.

Senator LEVIN. But you do not know why. You are saying it is not your department, but you just do not know why it was not added. Should it have been added?

Mr. GALLAGHER. Seemingly, absolutely it should have been added. I do not know why it was not.

Senator LEVIN. OK. In 2007—this is Exhibit 30<sup>2</sup>—a man named Mr. Barroso, who was head of the HBMX anti-money laundering program, was leaving the bank. He had an exit meeting with you, Mr. Bagley, I believe, and according to a meeting summary that you wrote, Mr. Barroso told you that there were allegations that “60 to 70 percent of laundered proceeds in Mexico went through HBMX,” and he did not think that senior management had any commitment to robust anti-money laundering controls.

That memo, I believe, Exhibit 30, was written to you, Mr. Thurston, if I have that correct.

Mr. THURSTON. That is correct, Chairman.

Senator LEVIN. What was your reaction when you got that memo?

Mr. THURSTON. Mr. Chairman, I was incredibly distressed. I do not think anybody wants to hear those sorts of things coming through, so we made sure that we investigated. We made sure that we took the points that were there. We had recently had discussion with the regulators in Mexico, and we made sure that we took account of those points within the remediation program that we were looking at in Mexico to make sure there was nothing new that we had missed. It also caused us to question whether our head of compliance was sufficiently good for the role as well.

Senator LEVIN. All right. Let me now turn to the Iranian issue, which Senator Coburn asked some questions about as well.

Now, Iran had been subject to sanctions in the United States for a long time as a rogue nation. It had long been on the U.S. SDN list, as we heard about this morning, as a prohibited country. Our laws consistently prohibited U.S. persons from doing business di-

<sup>1</sup> See Exhibit No. 18a, which appears in the Appendix on page 654.

<sup>2</sup> See Exhibit No. 30, which appears in the Appendix on page 703.

rectly with Iran, but until 2008, U.S. banks were allowed to process transactions that might involve Iran but which were sent to the United States by foreign banks located outside of Iran. Now, those transactions were called “U-turns” because they went from Iran to a non-Iranian bank, a foreign bank, then to a U.S. bank and then back to a different non-Iranian foreign bank and then to the final party. So there was a U-turn that was made through the U.S. bank.

The issue with HBUS is that the HSBC affiliates in Europe and the Middle East wanted to send U-turn transactions through their accounts at HBUS without triggering that OFAC filter or an individualized review to make sure that they were permissive U-turns. They wanted to remove any reference to Iran and to go through the HBUS systems without any manual or more detailed review. So this was a battle over transparency.

The United States wanted full transparency so that it knew it was dealing with an Iranian U-turn and could make sure it complied with U.S. law. The affiliates did not want to trigger these reviews or to take the time for those reviews. So HBUS and the affiliates fought over this issue for 3 years, from 2001 to 2004. But while they were arguing, the overseas HSBC affiliates were sending undisclosed Iranian U-turns through their HBUS accounts, anyway. And to do that, the HSBC affiliate in Europe, HBEU, stripped out the references to Iran. Senior employees at HBEU protested in 2003 and 2004—and I believe one of these protests was read by Senator Coburn—that they did not want to be altering wire transfer documents for Iran. They even set two deadlines in 2004 when they said that they would stop doing it, but both deadlines were ignored.

HSBC issued group-wide policy statements on Iran in 2005 and 2006, but neither resolved the U-turn issue. The issue was resolved only in 2007 when HSBC made a global decision to exit Iran.

Now, I believe that Exhibit 41 was referred to by Senator Coburn, and if so, I will not read it again.

Senator COBURN. I did Exhibit 40.

Senator LEVIN. OK. So Exhibit 40 was read by Senator Coburn, which made reference to the statement about, “I wish to be on record as not comfortable with this piece of business.”

Exhibit 41<sup>1</sup> was, “With the amount of smoke coming off of this gun, remind me again why we think we should be supporting this business?” So that is another HBUS employee describing the Iranian business. But at HBEU, the Europe branch, they were stripping payment information, so the United States was unaware of these Iranian payments.

Senior officials at HSBC, at the headquarters in London from 2001 to 2007, knew that affiliates in England and the Middle East, the HBEU and HBME, were sending undisclosed payments through their HBUS accounts but did not stop them or inform HBUS of the extent of the activity. So they knew that their affiliates were hiding key information from each other.

Now, at HBUS, senior compliance officials were on notice as early as 2001 that this stripping was occurring but took no decisive

<sup>1</sup> See Exhibit No. 41, which appears in the Appendix on page 760.

action to stop it. They stopped occasional wire transfers from Iran with the words, "Do not use our name in New York."

So, first, Mr. Bagley, didn't the European and Middle East affiliates—why weren't those affiliates told, why wasn't HBUS told, what possible justification is there for not telling an affiliate that key information to them so that they can comply with their own laws has been removed?

Mr. BAGLEY. It is a very fair question, Senator. My understanding of the position was that HBEU was checking each one of those transactions to ensure that they were U-turn compliant, that I was always advised that they were U-turn compliant. When I first focused on this issue, which was, I think, in mid-2003, although there were indications in emails before that, I emphasized and recommended that there should be full transparency given to HBUS so that they could check the U-turn compliance—compliance with the U-turn themselves.

Senator LEVIN. Was it?

Mr. BAGLEY. It was not.

Senator LEVIN. So as Exhibit 55 says so simply and eloquently and dramatically, your own people "were being asked to 'fudge' the nature of the payments to avoid the U.S. embargo and seizure." That is Exhibit 55.<sup>1</sup>

Then you were not the only one that was uncomfortable, Mr. Gallagher, with this piece of business. People in this bank, this global bank, were being asked to fudge the nature of the payments to avoid the U.S. embargo and seizure. And it is pretty shocking stuff.

Now, in 2002 and 2003, HSBC affiliates continued to send thousands of these undisclosed Iranian transactions through HBUS. Exhibit 1c<sup>2</sup> is a chart that shows the numbers. So even though the HSBC Group was on notice as early as 2001 that HSBC affiliates were sending these hidden Iranian transactions through their accounts in the United States, nobody did anything to stop it for years.

Mr. Bagley, in 2003, you had recently become head of compliance for the entire HSBC Group. Earlier that month, the Middle East affiliate, HBME, sent HBUS a memo laying out the business case for it to process Iranian transactions. Why were they processing them? Because there was a substantial income opportunity, and here is what you wrote in 2003, Exhibit 45:<sup>3</sup> "The business case includes a number of express references to practices which may constitute a breach of U.S. sanctions." But then in October 2003—and this is Exhibit 48<sup>4</sup>—one of your attorneys in Group Compliance, John Root, wrote to you that six banks were processing U.S. dollar payments and that these payments were being altered by HBEU before going to HBUS. He said HBEU was removing the remitter's name. Breaching these U.S. sanctions is a serious matter, and as the head of Compliance, you were making that point.

When you learned that HBEU was removing the names of Iranian banks, why was not the practice simply stopped right then? Why did it take so long to fix?

<sup>1</sup> See Exhibit No. 55, which appears in the Appendix on page 840.

<sup>2</sup> See Exhibit No. 1c, which appears in the Appendix on page 577.

<sup>3</sup> See Exhibit No. 45, which appears in the Appendix on page 784.

<sup>4</sup> See Exhibit No. 48, which appears in the Appendix on page 801.



Mr. BAGLEY. Mr. Chairman, that is an absolutely appropriate question, and with the absolute benefit of hindsight, this clearly took far too long to resolve.

What I can say is that when it came to my attention, I very clearly recommended that all transactions should be compliant, should be transparent, and should be made in a way which HBUS was comfortable with, and that recommendation went to the relevant parts of the group and ultimately was escalated to senior management within the group.

Senator LEVIN. How long did it take?

Mr. BAGLEY. I think as you have indicated, there were then various discussions between different parts of the group, and I think we progressively started to introduce transparency into the payments in 2006.

Senator LEVIN. So that would be about what, 3 years?

Mr. BAGLEY. Far too long.

Senator LEVIN. But about 3 years?

Mr. BAGLEY. Yes.

Senator LEVIN. Senator Coburn.

Senator COBURN. If a U-turn transaction is fully compliant and fully transparent, I would make the point it is legal, and nobody here is claiming illegality. But if one of these—and this is for you, Mr. Bagley. If one of these U-turn payments was not compliant with U.S. law, who is responsible?

Mr. BAGLEY. Ultimately I anticipate that the transaction passing through the U.S. bank may expose the U.S. bank to risk. And if there was malign intent, then it could expose somebody else to risk as well.

Senator COBURN. So in this great big organization called HSBC, is it fair for one profit center to put another profit center at that kind of risk? Not only is it fair, is it the right thing to do?

Mr. BAGLEY. I neither think it is fair nor the right thing to do, which is why I urged transparency so that HBUS could satisfy itself. But I would like to stress that at all times we were told and believed that those transactions were compliant and lawful and that there was a process where people seriously tried to ensure within HBEU that the transactions that were sent were compliant.

Senator COBURN. So it is your feeling—and you cannot know this for a fact because you have not looked at all of them. But it is your feeling that none of these transactions that HBUS saw no transparency on, it is your testimony that you feel that they all met the intent that our government says if you are going to run it through U.S. dollar banks, that you actually met that expectation?

Mr. BAGLEY. I do not think I can say that all of those transactions were. What I was always told was that people were seeking to ensure they were compliant—

Senator COBURN. Who are those people?

Mr. BAGLEY. The processing unit within HBEU.

Senator COBURN. And who are those? Who is the head of the processing unit at HBEU?

Mr. BAGLEY. I cannot recall the name.

Senator COBURN. Who could recall the name?

Mr. BAGLEY. I am sure we could find that name.

Senator COBURN. Would you do that for the Subcommittee, please?

Mr. BAGLEY. Absolutely.

Senator COBURN. I would love to have that name during our questioning this afternoon because that is a key point. Either they were legitimate U-turns or they were not.

Mr. BAGLEY. I believe that the results of the lookback that has been conducted by Deloitte indicates that most, if not all, of those transactions were compliant, or a significant number, I believe. That is not a report I have seen, but that is my understanding.

Senator COBURN. OK. And who has that report?

Mr. BAGLEY. I believe the results of that report have been disclosed to the Subcommittee.

Senator COBURN. OK. Thank you.

Mr. Lok, on Al Rajhi Bank, Exhibit 78,<sup>1</sup> if you would take a look at that. You were interested in carrying on a business relationship with this bank to sell it banknotes, as this email shows. Page 2 of the email also shows that one of your compliance people wrote, "I am not trying to be difficult," but that she did not want to approve the business.

What was your impression at the time why she would be concerned about being difficult?

Mr. LOK. The way I read her message, "difficult" refers to her reluctance to sign off the profile, and she is saying here that she is not comfortable signing it because she does not know the client.

Senator COBURN. Did she feel like she was being difficult because somebody was pressing her to approve something that she did not feel comfortable with?

Mr. LOK. No, that is not my interpretation. It is just because she was asked, and then she turned it down. That could be interpreted as difficult. I think that is what she is referring to.

Senator COBURN. All right. She also states, "I cannot answer questions if/when the Al Rajhi name appears in the U.S. media." What kind of concerns were you aware of that would rise to that level?

Mr. LOK. I know that this name had appeared numerous times in the papers, negative reports about the family members, and all sorts of allegations. So it is a very controversial name.

Senator COBURN. All right. You also, on page 1 of this email, wrote it is compliance that is the key. Were you suggesting that you needed to convince somebody in compliance to approve the deal or that you were willing to submit to whatever compliance said?

Mr. LOK. Because this is a very difficult case, it is not simple at all. When it was passed on to me by my colleague, on the one hand, there were these negative news in the paper, etc. But, on the other hand, there was this very supportive report coming out from the RMs based in Saudi Arabia. And at the same time, the Group Compliance had actually reversed its decision saying that they were happy to let individual entities resume doing business.

So, to me, it is a balancing act where you have some very bad news, but, on the other hand, you cannot ignore the news that appeared to be favorable. So that is why I presented this to the com-

<sup>1</sup> See Exhibit No. 78, which appears in the Appendix on page 937.

pliance so that we can engage in an open dialogue, show it to a few more people for elevating the issue, so that more people who know this thing a lot better than me can engage in and arrive at a decision.

Senator COBURN. And ultimately you did not do this deal? Is that correct?

Mr. LOK. I am sorry. No. I think after a very long period of time, New York Compliance had agreed to letting us resume the relationship. I mean the U.S. side. But it took a long time, because I had read this file before coming here, the dialogue first started in May, and then a decision was made in New York that we could resume for trading, that this was in December 2006.

Senator COBURN. OK. Thank you.

Senator LEVIN. Thank you.

Mr. Gallagher, take a look at Exhibit 50a,<sup>1</sup> if you would, when Denise Reilly of HBUS writes to Teresa Pesce at HBUS, anti-money laundering director, that the so-called Eastwood memo, which was referring to alterations to remove references to Iran, that the memo was discussed at a meeting with you, Mr. Gallagher.

This is dated December 17, 2003, so the question is—when you learned that HBEU was sending these hidden Iranian payments through their HBUS account, you saw it as a problem, you said so, and the real question is: What steps did you take to stop the practice? You objected to it. But what did you do beyond that?

Mr. GALLAGHER. Yes, thank you for that. I have reread these documents as well, and while I do not recall the specific meeting that is discussed there, mentioned there, I feel very comfortable about two things: First, that my position on this with respect to the necessity for transparency and full compliance was unchanged throughout the process; and, second, that this was really in the right hands. Denise Reilly at the time was in Compliance, I believe already, and Terry Pesce was the head of AML Compliance. So all the right hands from an HSBC Bank USA perspective into which this needed to be elevated were, in fact, contained in this memo. I do not recall my specific discussions here, but I would have to speculate they would be consistent with my prior positions, which is an abundance of caution.

Senator LEVIN. So you objected in 2001 to the practice. By 2003, you were the head of the HBUS's Payments and Cash Management Division. Why not just pick up the phone in 2003, call the CEO of HBUS or somebody in the HSBC Group and just raise hell? Why not do that?

Mr. GALLAGHER. Well, certainly with——

Senator LEVIN. I think you knew whoever was supposed to be taking care of it was not taking care of it.

Mr. GALLAGHER. Yes. With the benefit of hindsight, that is exactly what I should have done, and I think we have all learned the lesson that we should have been louder sooner and more broadly in the organization.

<sup>1</sup> See Exhibit No. 50a, which appears in the Appendix on page 807.

Senator LEVIN. Mr. Lok, let me ask you about Exhibit 84b.<sup>1</sup> You were the head of HBUS's global banknotes business that supplied physical U.S. dollars to financial institutions around the world. Some of your clients, to put it mildly, did not inspire confidence and were either opposed by HBUS's Compliance, the division there, or they sought to subject them to special anti-money laundering monitoring. But you often opposed those recommendations, and here are a few examples, 84b is one.

This is an email exchange in 2005. This was about whether to classify a particular HBUS banknotes client as a special category client (SCC), which means that is a high-risk client that undergoes additional scrutiny.

HBUS Compliance described the foreign bank as one in which, "the bank's senior management and employees have been involved in numerous significant instances of corruption, fraud, and embezzlement over the past few years," and recommended that it be classified as a SCC.

You responded as follows: "Yes, corruption can be rampant in this bank, but it is not unique" to that bank. So you opposed the SCC designation.

Now, the HBUS compliance officer for banknotes, Daniel Jack, described a bank as "government-owned, in a high-risk country with a politically exposed person," which is someone who requires enhanced due diligence, "and reputational risk due to corruption, etc." This is now Exhibit 84a.<sup>2</sup> And he recommended an SCC designation, and your response: ". . . this is such a large bank hence malfeasance is expected."

"However," you wrote, "I do not agree that just on these numerous breaches that the bank should be classified."

So your position was that malfeasance is to be expected at a large bank so do not even bother to do additional anti-money laundering monitoring.

And then Exhibit 82<sup>3</sup>—this is from 2007—in this email chain, an HBUS banknotes colleague asks if you—and, Mr. Lok, we are referring to you—would be willing to help open a banknotes account for Islami Bank Bangladesh, which was partly owned by Al Rajhi Bank, a Saudi Arabian bank whose account was closed by HBUS in 2005 for terrorist-financing reasons, although in part in 2007, because of your urging, HBUS reopened that account.

Here is what you wrote: "I am happy to be the relationship manager if this is an account worth chasing. How much money can you expect to make from this name?"

And then when you were told the account would produce about \$75,000 in revenues per year, you wrote: "One, the money is there, and we should go for this account. Two, I will jump in and wear the [global relationship manager] hat."

So your test, apparently, for opening an account was, first, how much revenue it would produce, but what about the second test, Mr. Lok? What about a test is the bank involved in wrongdoing, whether it is terrorist financing, corruption, or malfeasance? Why

<sup>1</sup> See Exhibit No. 84b, which appears in the Appendix on page 964.

<sup>2</sup> See Exhibit No. 84a, which appears in the Appendix on page 958.

<sup>3</sup> See Exhibit No. 82, which appears in the Appendix on page 949.

weren't those factors enough for you to say we are not going to do it?

Mr. LOK. Mr. Chairman, let me try to explain what had happened. Exhibit 84b,<sup>1</sup> that was about classifying that particular client in China as a SCC. The thinking was China is a different country from a lot of other countries. It has its own characteristics. And this bank actually shared the same characteristics of the other big banks as well. So it is not one just on this particular bank. So my point at that time was if FIG, which is a unit within Compliance, wants to say that this should be SCC, that means the other banks should also be subject to the same rating.

Senator LEVIN. Well, why not all banks that, in your words, where corruption is rampant? Why shouldn't they all be subject to that rating?

Mr. LOK. First of all, I have to apologize the colorful words I used that. It was not the appropriate—

Senator LEVIN. Apologize to whom?

Mr. LOK. Well, that email give the impression that I was very tolerant of this malfeasance. That is why I said that the word itself is not the right word to use.

Senator LEVIN. I am afraid it was the right word to use if you believed it. Corruption was rampant at that bank. Did you believe it was rampant?

Mr. LOK. Well, it is a very large organization. I think just like other organizations, when you have such a large bank, yes, there are bound to be cases of malfeasance.

Senator LEVIN. You did not really mean what you said, that it was rampant? Is that what you are saying? At the time you wrote it was rampant and that it was not unique to that bank. So were you inaccurate in your email? Did you express what you believed at the time?

Mr. LOK. At that time, yes, but I need to qualify that statement, which is the email came forward, I was overwhelmed by this feeling that if this bank were to have been SCC, that means the other banks need to be SCC. And at that time China was a country that the group itself looked at as a very important market. So I wanted to elevate the issue. That is why I copied my colleagues in London, bring in Group Compliance, take a look at this. That was what I was trying to do at that time.

Senator LEVIN. What about your Exhibit 84a?<sup>2</sup> Here you are recommending you proceed despite the fact that the compliance officer for banknotes, Daniel Jack, described this as a government-owned bank in a high-risk country with politically exposed persons that require enhanced due diligence and a reputational risk—that is to you, to your bank—due to corruption. And your recommendation was go ahead anyway. “It is a large bank. Hence”—your word—“malfeasance is expected. I do not agree,” you said, “that just on these numerous breaches the bank should be classified”—in other words, given enhanced review.

Did that reflect your view at the time? Did you believe what you wrote at that time?

<sup>1</sup> See Exhibit No. 84b, which appears in the Appendix on page 964.

<sup>2</sup> See Exhibit No. 84a, which appears in the Appendix on page 958.

Mr. LOK. At that moment, yes.

Senator LEVIN. OK. What about this Bangladeshi bank? When you said—all you seemed to be interested in is how much money will it make for us, how much money can we expect. Then \$75,000 in revenues. And then you say, “We ought to go for it.” You will be happy to wear the hat, the global relationship hat.

You are head of the Banknotes Department, and when your employees see those kinds of remarks in your emails from their boss, what kind of an impact do you think it has on their willingness to consider compliance issues when deciding whether to open an account for a potentially lucrative but a high-risk client? What do you think the effect of those words are on your employees?

Mr. LOK. Mr. Chairman, I agree that this is not portraying a right image, not giving the right message, looking at the message right now.

Senator LEVIN. Senator Coburn.

Senator COBURN. Just for the record, the email that Mr. Lok sent did not say it was rampant. It actually said “can be rampant.” And some of the realism of the world we live in in global commerce, if you take this particular bank—and this is not a defense, but if you look at their own bank in Mexico, I would tell you it looked like it could be rampant there as well. And I think that Mr. Thurston certainly found that, that corruption could be rampant in that.

I think we have a better understanding, Mr. Chairman, of what went on. Someone taught me a long time ago that greed tends to conquer all technologic difficulties, and so we are about anti-money laundering. That is what this hearing is about. And it is not the accusation of illegality. It is the accusation of poor judgment and mistakes and not good line authority inside a very large and very successful organization.

I would just say, one, I appreciate the candor of the witnesses today. It is a very difficult issue. I am still concerned even though Deloitte said there are 79 accounts they could not account for in terms of U-turns. I still think it is a difficult issue when the world is dealing with a terrorist state like Iran and we are allowing them the flexibility. So my hope is that we can learn some things, and I know HSBC certainly has, and I appreciate our witnesses’ testimony.

Senator LEVIN. Thank you, Senator Coburn. I think I read the email correctly. I will read it again. “Yes, corruption can be rampant in this bank, but it is not unique to” the bank.” And so I think it speaks for itself. If I at one point said that he said it is rampant instead of, “Yes, it can be rampant” and “it is not unique,” then your quote is exactly right, and the one I just read I think is also exactly right. But there is not much difference between “it can be rampant” and “it is not unique” to what the point was of this question and Mr. Lok’s answer.

[Pause.]

Senator LEVIN. We thank our witnesses, and, again, we appreciate the cooperation with this investigation of your bank.

We are going to recess now until 2 o’clock. We thank our witnesses, and you are discharged.

[Whereupon, at 12:34 p.m., the Subcommittee was recessed, to reconvene at 2 p.m., this same day.]

Senator LEVIN. The Subcommittee will now come back to order. I would like to call our third panel of witnesses for this hearing, Irene Dorner, the President and Chief Executive Officer of HSBC Bank USA and HSBC North America Holdings in New York; and Stuart Levey, the Chief Legal Officer of HSBC Holdings in London.

We welcome you both. We appreciate both of you being with us this morning. We look forward to your testimony, and we also want to tell you that we appreciate the cooperation of your bank. It has been consistently cooperative with us and we are grateful for that.

Pursuant to Rule VI, all witnesses who testify before the Subcommittee are required to be sworn, so I would ask you both to please stand and raise your right hand.

Do you swear that the testimony you will give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Ms. DORNER. I do.

Mr. LEVEY. I do.

Senator LEVIN. The timing system that we have will give you a red light after 5 minutes, but a minute before that it will shift from green to yellow to give you an opportunity to conclude your remarks. Your entire written testimony will be printed in the record. And we would, again, appreciate that you attempt to limit your oral testimony to 5 minutes each.

Ms. Dorner, we will have you go first, followed by Mr. Levey, and then we will proceed to questions. But first, let me turn to Senator Coburn.

Senator COBURN. Thank you. I privately greeted our witnesses and I would apologize. This afternoon, I will be in and out, but I will be here to ask my share of the questions. So if you are in the midst of your testimony and I leave, please forgive me.

Senator LEVIN. Thank you very much, Senator Coburn. Ms. Dorner.

**TESTIMONY OF IRENE DORNER,<sup>1</sup> PRESIDENT AND CHIEF EXECUTIVE OFFICER, HSBC BANK USA AND HSBC NORTH AMERICA HOLDINGS, INC., NEW YORK, NEW YORK**

Ms. DORNER. Thank you, Chairman Levin and Senator Coburn. My name is Irene Dorner and I serve as President and CEO of HSBC Bank USA and HSBC North America Holdings, Inc. I have led the bank in the United States since January 2010.

I fully appreciate why we are here and believe that the discussion about controls at global banks is an important one to have. We deeply regret and apologize for the fact that HSBC did not live up to our own expectations, the expectations of our regulators, our customers, our employees, and the general public.

HSBC's compliance history as examined today is unacceptable. HSBC has learned some very hard lessons from the experience of the past few years, but we have taken very substantial steps to address the problems that we, our regulators, and this Subcommittee have identified. We have made fundamental changes in governance, culture, training, and funding to ensure that we can effectively deter illicit use of our bank in a manner that will be embed-

<sup>1</sup> The prepared statement of Ms. Dorner appears in the Appendix on page 130.

ded and sustained going forward. The process is ongoing and requires vigilance.

As you know, these issues and challenges do not end at the water's edge, so we are combining our efforts with reforms that apply throughout HSBC's global businesses, and I am joined today by our new Chief Legal Officer, Stuart Levey, who is here on behalf of the HSBC group, and who will describe HSBC's global compliance commitment.

Given my experience working for HSBC in other parts of the world, I am cognizant of the risks and obligations that come with serving our customers who have a need for global banking services, and at an absolute minimum, we must have the proper controls and systems in place to ensure that we are doing the right business in the right places with the right customers and that our customers' transactions are properly monitored. If, for any reason, a transaction appears to be unlawful or suspicious, then we scrutinize the customer and report this information to the authorities in a timely manner.

As the Subcommittee has documented, we have fallen short in a number of serious ways. In October 2010, the U.S. bank entered into a consent order with the OCC. With the full support of our board and of the HSBC group, I took the lead in overseeing our remediation efforts and we have taken significant steps.

First, we have worked hard to foster a new culture that values and rewards effective compliance and that starts at the top. By the end of 2010, we had a new U.S. senior management team in place. We overhauled our AML compliance function, improving the quality, coverage, and strength of our AML program through additional staffing and training. We have increased spending in AML compliance nine-fold from 2009 to 2011. And today, we have 892 full-time AML compliance professionals.

Second, we have undertaken an enterprise-wide risk assessment and have exited customer relationships and businesses that do not represent acceptable manageable risks. This is an ongoing process and we continue to do a formal risk assessment twice a year.

Third, we have made changes to our "know your customer" policies because proper KYC must be robust to be effective. We must know a significant amount about our customers to be satisfied that we want their business. Our new KYC policy delivers a critical look at each customer, including our own HSBC affiliates. We have also implemented a new customer risk rating methodology which takes a holistic view of customer risk. I chair the project to apply our new KYC standards to our entire customer base. Many of the changes we are making are being adopted as HSBC Global best practices.

And finally, we have made significant investments in technology and we have built better controls around our automated monitoring system, although we recognize that there is more to be done. The intended consequence of these changes is to embed a new culture of responsibility, accountability, and deterrence within our U.S. bank. It has been my mission and the mission of my new senior team to make sure that compliance is on every employee's mind at every level in the organization.

In closing, let me say that I do appreciate this Subcommittee's efforts to examine and improve the steps taken by industry and



government to address these challenges and the recommendations you have made. We are committed to fulfilling our responsibilities in an effective and sustained manner.

Thank you, and I am happy to address any questions.

Senator LEVIN. Thank you very much, Ms. Dorner. Now, Mr. Levey.

**TESTIMONY OF STUART A. LEVEY,<sup>1</sup> CHIEF LEGAL OFFICER,  
HSBC HOLDINGS PLC, LONDON, ENGLAND**

Mr. LEVEY. Thank you, Mr. Chairman and Senator Coburn. My name is Stuart Levey. I am the Chief Legal Officer of HSBC, a position I have held for the past 6 months. I am pleased to be here at the Subcommittee's request to participate in today's hearing, and I would also like to express the appreciation to the Subcommittee staff for its hard work and professionalism.

Some of the information discussed earlier today and in the Subcommittee's report is sobering. It highlights serious historical problems at HSBC, and we have not shied away from that. In fact, we have gone to great lengths to cooperate, not only to be helpful to you, but to help us diagnose the problems and identify solutions. We obviously have a great deal of work to do.

I know from experience that it is critically important to our safety and security to stop illicit actors from gaining access to the financial system. At HSBC, we must do everything in our power to prevent that access through our bank and we embrace that responsibility. That is why we are taking action not only to address the specific deficiencies the Subcommittee identified, but also to implement a global strategy to tackle their root causes. This is a complex undertaking, given the scale of our institution and our multinational footprint. But if we get this right, it will make a difference.

At the beginning of 2011, there was a transition at HSBC to a new CEO, Stuart Gulliver, and our new Chairman, Douglas Flint. Our new leadership team understands these challenges and they approached me to join them to help drive the necessary changes. My views on these issues were public and well known and HSBC's leadership wanted me to bring my experience and commitment to bear on their challenges.

I would like to outline for you the path that we are on. First, beginning in January 2011, we have reorganized HSBC around four global businesses and 10 global functions. This means for the first time that the global head of a function, like myself, has authority over the operations and personnel of that function wherever we operate. This makes it easier to manage our risk globally. The historical decentralized corporate structure that concentrated authority on country heads has been replaced.

Second, we have simplified our business model to make HSBC easier to manage. We are reducing our footprint and product lines. We have focused on selling and exiting non-core businesses, such as our global banknotes business. Over the past 18 months, we have sold or exited 31 businesses and are already withdrawing from nine countries.

<sup>1</sup>The prepared statement of Mr. Levey appears in the Appendix on page 137.

Third, we have elevated and strengthened the role of group compliance so it is now in power to set standards across the organization and has the necessary authority to ensure that those standards are enforced. Our new Chief Risk Officer, Marc Moses, is also providing fresh leadership in this area.

Fourth, on April 30 of this year, our CEO issued a directive to the entire bank requiring adoption of high uniform standards across the firm. We are adopting a highest common denominator approach, applying everywhere the highest standard that we must apply anywhere. That will most often mean that we will be applying U.S. standards globally. This means that instead of the United States taking on risk from abroad, as you discussed in your opening statement, Mr. Chairman, instead, high U.S. standards will be exported globally, thereby promoting the integrity of the financial system.

Among other things, that directive, or group circular letter, also requires that we maximize information sharing for risk management purposes and that we apply a globally consistent approach to knowing and retaining our customers. The CEO has also directed the Chief Risk Officer and me to co-chair a steering committee, on which Ms. Dorner also sits, to drive implementation of this new approach.

We have already begun our work. For example, we adopted a new global sanctions policy. We ordered global application of the obligation to conduct affiliate due diligence. And we adopted a new risk filter to reduce and better control the business we do in any high-risk country where we operate. This is the process under which we decided to close the Mexican Cayman accounts that were discussed this morning.

This is the beginning of the journey and we have a long way to go, and we agree with you, as you say in your report, that the burden of proof is on HSBC to demonstrate progress on these reforms.

In addition, in 2011, our CEO introduced a new values program under which all senior executives are evaluated on whether they adhere to the bank's core values, including respect for compliance.

In the end, sustainability of these reforms depends critically on the commitment of HSBC's top leadership. I have confidence because I know our board and senior leadership are committed to seeing these reforms through. We understand that this is something that absolutely must be done for the long-term success of the bank.

I appreciate the opportunity to speak to you today and I look forward to answering your questions.

Senator LEVIN. Thank you very much, Mr. Levey.

Let me start. We will have, I think, a 10-minute round.

Senator COBURN. You may go 20 minutes.

Senator LEVIN. OK. In 2003, HBUS was the subject of a formal enforcement order by its regulators at the time, the Federal Reserve of New York and the New York State Banking Department, and it required the bank to revise and revamp its AML program due to some very serious deficiencies. HBUS made a commitment at that time to correct the problems. And after 3 years, in 2006, the Office of the Comptroller of the Currency (OCC), lifted the enforcement action despite a host of unresolved issues.

Four years later, in 2010, the bank was right back in the soup, the subject of another enforcement action by its regulator, this time the OCC, requiring the bank to revamp its AML program due to severe deficiencies. And many of those were similar to the problems that had been identified in 2003, including many violations of Federal AML law, a backlog of over 17,000 un-reviewed alerts regarding possible suspicious activity, failure to conduct any anti-money laundering monitoring of \$60 trillion annually in wire transfer activity by customers domiciled in countries rated by HBUS as lower risk, and failure to conduct any due diligence of HSBC affiliates.

Now, on April 30 of this year, the HSBC group, as you have testified, issued a new group-wide policy that applies to all of its affiliates around the world, and that is Exhibit 2b.<sup>1</sup> Now, this group circular letter requires all HSBC affiliates to meet the most stringent standards anywhere in the group, and it states that, "The bank and its affiliates will adopt and enforce the adherence to a single standard globally that is determined by the highest standard that we must apply anywhere. Often, this will mean adhering globally to U.S. regulatory standards. But to the extent another jurisdiction requires higher standards, then that jurisdiction's requirements must shape our global standard."

That new policy statement could be a groundbreaking commitment that will force the entire HSBC network to improve, and I hope it does. I understand, Mr. Levey, that you are co-chairing a committee—you have just testified about that—aimed at implementing the new group circular letter.

But here is what HSBC said in 1993. "Group members should comply with both the letter and spirit of all relevant laws, codes, rules, regulations, and standards of good market practice in each jurisdiction around the world where they conduct business."

The 2012 and the 1993 compliance policy statement have good sentiments and they sound very similar in a lot of regards. They promise the bank will adhere to high standards, and as I have said before, commitments and promises are welcome. But accountability for previous failures and conduct that has already taken place is essential as a deterrent, and it is that accountability that has been missing.

My first question is the following, and either one of you can answer. Let me try you first, Ms. Dorner. Do you agree that given past commitments that have not been kept that the bank has a heavy burden of proof that they mean what they say, or you mean what you say, both as to changing behavior and as to changing the culture?

Ms. DORNER. Thank you, Mr. Chairman. I can entirely understand these concerns. It is quite clear that we have had failures in the past, which we deeply regret, and I would agree that we have some way to go to regain the trust of our regulators and of yourselves on this Subcommittee.

Senator LEVIN. Thank you.

Exhibit 71d<sup>2</sup> is a chart which was prepared by an outside auditor at HBUS's request. It lists accounts that are held by HSBC af-

<sup>1</sup> See Exhibit No. 2b, which appears in the Appendix on page 583.

<sup>2</sup> See Exhibit No. 71d, which appears in the Appendix on page 923.

filiates in the United Kingdom and Hong Kong for banks in rogue regimes subject to U.S. sanctions, such as Iran, Iraq, North Korea, and Sudan, a total of 55 suspect banks with U.S. dollar accounts made possible by the HSBC affiliates' correspondent accounts at HBUS.

Basically, how could HSBC affiliates accept such clients and do you know whether HSBC told HBUS that it was servicing these type of clients?

Ms. DORNER. Mr. Chairman, clearly, this predates my tenure of being in the United States and so I cannot comment specifically on this. I can tell you now that HBUS does not hold accounts for any of these names.

Senator LEVIN. Thank you.

One of the accounts that was in an HSBC affiliate is a U.S. dollar account for an Afghan bank on the SDN list from October of 1999 through February 2002. It was on the SDN list because of its ties to the Taliban. It is incredible to me that an affiliate of HSBC, an affiliate which is located in the United Kingdom, could even consider owning an account for a Taliban-affiliated organization and continue the relationship after the September 11, 2001 attack.

Now, there is another extraordinary example here, as well, and that is Exhibit 50d.<sup>1</sup> That is an exchange of emails in 2008 between HSBC employees in the U.S. and the Cayman Islands. An AML compliance officer at HBUS received an inquiry from OFAC regarding a trust account in the HSBC Cayman affiliate which was administered by HSBC Geneva and which had been established to benefit a well-known international terrorist named Rami Makhoul. He is from Syria. The exchange is stunning, if you will take a look at this one.

The Internal Control Officer for Compliance in the Cayman Islands admits that the trust for Makhoul exists and the Cayman affiliate is the trustee. In a subsequent email, she informs the HBUS AML officer that a year earlier, in 2007, concerns about this client were raised and the relationship was viewed at the group level, which decided to maintain it. In other words, people at HSBC headquarters made a conscious, knowing decision to maintain the account for the benefit of an international terrorist.

So how is it that HSBC Geneva or its Cayman affiliate, or any affiliate in the HSBC system, could have maintained a trust benefiting a terrorist or gotten permission from group headquarters to service such an individual, and if you wish to comment, as well, on that account that was being held for a Taliban-affiliated organization, you can do so at the same time. Ms. Dorner.

Ms. DORNER. Mr. Chairman, I am afraid I am not able to assist you on the account for Mr. Makhoul because he is not a customer of HBUS and I am not acquainted with this chain of events.

Senator LEVIN. Could you become acquainted and then give us your comment for the record?

Ms. DORNER. I can look at the chain of emails, yes.

Senator LEVIN. Will you do that?

Ms. DORNER. I can do that.

Senator LEVIN. OK. Mr. Levey, do you have a comment?

<sup>1</sup> See Exhibit No. 50d, which appears in the Appendix on page 823.

Mr. LEVEY. Naturally, this is long before my tenure. I do know who this individual is. He is someone that we designated when I was in the government. He was designated in 2008, I am pretty sure, under the sanctions program by the United States. I do not think this is the kind of thing that we need to change. I do think this is the kind of thing that we need to change.

Senator LEVIN. You made reference to your service with the U.S. Government. If I remember, you were the Under Secretary of the Treasury for Terrorism and Financial Intelligence. Do I have it right?

Mr. LEVEY. Yes, sir.

Senator LEVIN. How would you have reacted if you knew that HSBC was engaged in such a practice and that an HSBC affiliate knew of the HSBC account and did not report it?

Mr. LEVEY. I think that would be unacceptable.

Senator LEVIN. Would it not be even stunningly unacceptable? I mean, a lot of things are unacceptable. But on degrees of unacceptability, is this not kind of shocking?

Mr. LEVEY. I am not going to quarrel with you, Senator. Of course, this is exactly the kind of thing, I should say, that we are trying to change, where we are trying to make important compliance information mandatorily shared to compliance officers around the world. This would be the kind of thing that would, in my view, fall into that category.

Senator LEVIN. Senator Coburn.

Senator COBURN. Thank you.

Ms. Dorner, as I understand from the report, you arrived to run the U.S. affiliate or the U.S. organization in 2010 and were handed a pretty good sized mess. But why, irrespective of these challenges, does HSBC choose to have a presence in the United States in the first place? I mean, what is the value to HSBC? You are in all these countries. You are worldwide. What is the value? Why are you here?

Ms. DORNER. Senator, that is a great question. This is a terrific place to do business. There are more than 10,000 U.S. headquarters of international companies based here in the United States. We, as an international bank, it is our business to help our customers realize their aspirations. And so we have many United States companies who want to grow internationally and they use us and we help them to do that. We connect them with international business.

And then there is incoming business, and, of course, as you know, we do have businesses in other parts of the world, and I am thinking particularly here of Asia and emerging markets, where many companies wish to do business and wish to invest in the United States. And it is the role of HSBC as an international bank to facilitate that. The United States is the biggest trading Nation in the world. It is a massive opportunity.

Senator COBURN. So given the mess you have had and what you have seen, the consequences, both financial and from a business standpoint, as a result of the consent order with OCC, would you outline what the impacts have been on your organization, the latest consent order?

Ms. DORNER. The latest consent order has had a massive impact. Clearly, it happened just after I arrived, and I can tell you that what we have done is that we have changed the senior management here in the United States. We have changed our General Counsel. We have changed our Head of Compliance. We changed our AML Director. We have had a top-to-bottom overhaul of the way that we actually do AML compliance. We are burning the bridges to make sure nobody can get back to the way it was before. We have new governance in place. We have new structures. We have new policies.

But actually, the processes and the policies are never enough. This is actually about the people. And so it is my job to make sure that the right way down the whole organization, the DNA of HBUS, we actually get compliance on the front foot in everybody's mind.

And in terms of fixing it, that is what CEOs do. I am clearly absolutely committed to fixing this. But the reality is, the change that will take place and is taking place is that this has to be fixed for the future. This has got to be BAU. So business as usual is not just about fixing the consent order. It is driving this through into the future as a full-scale remediation that will last.

Senator COBURN. So you put all these steps forward and all these changes, but the real thing that you have to change is the culture.

Ms. DORNER. That is correct, Senator.

Senator COBURN. So how are you doing that? I mean, you have outlined the steps, but where is the leadership that is going to change the culture? Where is the example so far since you have been there changing the culture? When somebody has violated some of these policies, what has been the consequence? The only way you change a culture is if everybody in the organization sees when you violate the core values of the institution that there is a consequence.

Ms. DORNER. Senator, I can tell you unequivocally since I have been here that I have fired people for not complying, that I have clawed back in terms of future remuneration, and I have reduced compensation. Of course, that is the negative side of things. Equally, we have celebrated success. We have examples of compliance officers who have been put onto our Internet to show people that this is where it is at that they should be looking at, these kind of standards to drive the way that we do business. It is quite clear that we need to make further changes. There is never enough done. We can always improve. But this has got to be on everybody's lips, from top to bottom of the organization.

And I would just say that one of the big changes that has helped me in this is that this group has changed in terms of how it wishes compliance to be viewed, and compliance now has a control function role within the whole group. And so I am totally supported by the HSBC group in this and by the HSBC group's senior management.

Senator COBURN. OK. I just have one more question for you. You mentioned the changes you made to "Know Your Customer" policies have enabled you to make better decisions about whether a customer fits your risk appetite. Would you describe what your risk appetite is at HSBC or HBUS?

Ms. DORNER. I can do that. I think that the thing about risk is it has to be taken at the highest level. You are trying to find the right customer, and so it is about understanding customers' business, where they do business, why they do business, and what they want to do with us. And, therefore, when you put a KYC process in place, those are the things that you are looking for throughout, and not only are we looking for that in our future customers, we are actually remediating the existing customer base we have to make sure that the customers that we already have fit within the risk appetite that we have. And I can tell you now that we have exited, as a result of rolling out this remediation, in the order of 14,000 customers because they simply did not fit our risk appetite.

Senator COBURN. OK. Thank you.

Mr. Levey, this was a 300,000 person organization. You have an impressive resume, but there is just one of you. And you have entered into an organization that has an admittedly poor record and presumably a poor culture for compliance to match that poor record. When you leave here today and resume business as usual, go back, what is going to be the impact of a hearing like this or a meeting with the government like this in terms of how it affects the bank, the bank operations, the structure, and the culture?

Mr. LEVEY. Well, Senator, I can assure you that the top leadership of this company is very focused on your report, on this hearing, on all the information that has been developed in the course of this investigation. In fact, it was not just when the report was issued or we were coming to testify today that there was engagement from the top. As I said, the change began when the new CEO took office at the beginning of 2011 and they reached out to me soon thereafter to ask if I would come and help drive the change that they were pursuing.

I believe that the culture and the tone at the top is excellent. We have risk management meetings where the top executives of the firm sit around the table and we share the information in ways that apparently did not happen as robustly before and make the kinds of decisions that are necessary for controlling these sorts of risks.

I believe that this whole experience is one in which, as our CEO has said, we are going to be judged by how we respond to this sort of adversity, and he is absolutely committed to getting this right—in large part, because we think it is critical to our success. If we are going to be a successful, the leading international bank, which is our aspiration, we have to be successful at this. We have to lead in this area, as well.

Senator COBURN. Is there a conflict within your board to—I am trying to think of the best way to phrase this—compliance here does not necessarily have to be difficult, but it has to be right, and there are some variables that affect that. How well do the regulators do? Are they fair? But are they trying to do the right thing, not just be right? Is there a conflict or tension between the potential, as Ms. Dorner outlined, of being a global bank with a large number of multinational countries here, and the cost of compliance, because I actually see that is where things really went awry. How do you manage that tension so that when they are looking—if this is a great business opportunity for HSBC, is this too much of a

compliance hurdle or cost given the potential capital appreciation opportunities for your organization?

Mr. LEVEY. Senator, I do not believe we view this as a tension or a tough call. We are going to have to get this right, whatever it takes to get this compliance in order. I do not think there is any ambivalence about that on our board. And we view it as our responsibility—quite aside from the regulators, candidly—it is our responsibility to get this right and we appreciate the help we have had from the Subcommittee and the recommendations, but we have—it is our responsibility to look at those and improve and also identify the improvements ourselves that we need to make.

Senator COBURN. With the changes that Ms. Dorner has put in and with your expertise, is it your opinion that not only will you be better in terms of compliance, but you will be a better organization and a more profitable organization as a result of it?

Mr. LEVEY. I agree with that entirely, Senator. I think that there is no conflict in the long run between those two things. Being compliant, having the right controls in place, is in our long-term financial interest.

Senator COBURN. Thank you, Mr. Chairman.

Senator LEVIN. I want to go back just for a moment to that situation with the Syrian terrorist. There was an inquiry from OFAC. We want to start with that. It was an inquiry regarding a trust account in the HSBC Cayman affiliate that was administered by HSBC Geneva. What happened then is that an AML officer at HBUS—and this, again, is Exhibit 50d<sup>1</sup>—an AML officer at HBUS wrote the following, “that we have determined that accounts held in HSBC Cayman are not in the jurisdiction of and are not housed on any systems in the United States. Therefore, we will not be reporting this match to OFAC.”

So HBUS knew the account existed, knew that there had been a request about this account from OFAC, knew that an HSBC affiliate maintained it, but was not going to get that information to OFAC based on this jurisdictional line. In effect, what the AML official decided to do is to use the affiliates’ separate entity status as a reason to not report a Syrian terrorist’s HSBC account to OFAC.

So we have HSBC crossing international lines to establish and service the trust, to protect its assets, and to facilitate Makhlouf’s transactions. And this is 2008, by the way. And yet they rely on that technicality not to report the information to OFAC.

And so my question to you folks is, if this same thing happened today, would you get that information to OFAC?

Mr. LEVEY. Mr. Chairman, I am—obviously, this is, again, several years before I arrived. I do not know the details of what happened here. What I can tell you is that one thing we have done that would handle this kind of situation is that we have now adopted a global sanctions policy so that anyone who is designated by OFAC will be—we will search across the entire bank in all jurisdictions and all currencies to ensure that we catch all those situations and either freeze accounts if we are permitted to, because in some—if it is a U.S.-only designation, we may not be able to freeze

<sup>1</sup> See Exhibit No. 50d, which appears in the Appendix on page 823.



the account—or exit or reject transactions. I am not in a position to go into the details of transaction.

Senator LEVIN. Well, I think you have answered the question, without going into details. You are saying that, first of all, every affiliate is going to apply the same catch mechanism. So, presumably, they would have caught this.

Mr. LEVEY. Yes. What I do not know——

Senator LEVIN. If it would have been caught by HBUS, it would have been caught by Cayman.

Mr. LEVEY. Right.

Senator LEVIN. Right? OK. Presumably.

Mr. LEVEY. Presumably, yes.

Senator LEVIN. It should be.

Mr. LEVEY. What I do not know is when Rami Makhoul was actually designated. I do not have the date in my head.

Senator LEVIN. Well, putting aside that, the question is, presumably, it will be caught by the same mechanism being applied in every one of your banks, wherever they are located. My question, though, is if for some reason it fails and if one bank knows that information is being sought by OFAC, will it make sure that the information is provided?

Mr. LEVEY. Again, my view on this would be that we would give to any government as much information as we are legally permitted to do when we had a valid request. So I cannot tell you whether there will be some legal restriction, but we would do everything we could to get them the information.

Senator LEVIN. Well, when you say what you are legally permitted to do, were you legally permitted by the Caymans, by their law, to provide this? Do you know, Cayman law will not allow this. They are a secrecy jurisdiction.

Mr. LEVEY. I do not know, Senator.

Senator LEVIN. Well, but you need to find out.

Mr. LEVEY. Will I find out?

Senator LEVIN. Are you going to be bound by a secrecy jurisdiction's law that says you cannot share that information, or are you going to be carrying out your commitment here that you are going to treat all of your affiliates as though they are in one place globally and you are going to respond to law enforcement with their request? I mean, if you are going to say, if legally permitted by the Caymans or by any other country, you have tax havens, and so forth with secrecy jurisdictions, Caymans being one of them. Are you bound by that? Are you going to work with law enforcement or are you going to be bound by Caymans?

Mr. LEVEY. We are going to do everything we can to cooperate with law enforcement.

Senator LEVIN. Well, you say, though, that if it is legally permitted. That is your hedge word. U.S. law binds you to report to OFAC. What are you going to do, live up to Cayman law or U.S. law?

Mr. LEVEY. I do not know if there would be a conflict there.

Senator LEVIN. There is. Assume there is.

Mr. LEVEY. If there is, we do everything we can to get it to OFAC.

Senator LEVIN. To comply with U.S. law?

Mr. LEVEY. Yes.

Senator LEVIN. Now, sharing information across international lines is not just an ancient problem at HSBC, it is still a current problem, and I am going to give you what has happened recently involving this Subcommittee. In 2010, in a hearing before this Subcommittee, we reviewed an incident in which an HSBC affiliate in the Bahamas was asked to open an account for the Central Bank of Angola. Email exchanges obtained by the Subcommittee made it clear at that time that the Angolan Central Bank wanted to use an offshore secrecy jurisdiction—that is the Bahamas—to hold its funds in order to avoid court orders that might lead to a freezing of its funds. At the 2010 Subcommittee hearing, I asked HSBC if the account was ever opened, and not surprisingly, HSBC refused to answer, citing jurisdictional constraints.

Last week, HSBC informed us that the account had been opened and was opened at the time of our 2010 hearing, but that it was closed 45 days ago. HSBC also revealed that the only reason it could provide that information to the Subcommittee was because HSBC had received permission from the Central Bank of Angola. HSBC Bahamas could not release it to HBUS without the client's permission, so that is the problem with what you are telling us today. It is the problem with HSBC's word, the subject of being legally permitted, that description, which is a real big loophole, and it is a problem with other international banks.

The international banking system established a financial system that enables them to facilitate financial transactions and move around the globe across jurisdictional lines in a matter of seconds, but when it comes time to sharing critical information with U.S. authorities about clients and their accounts and transactions, then things begin to grind to a halt and banks point to jurisdictional rules and local laws, sometimes using that argument disingenuously. But putting that aside, that is the reason given by HSBC not to share that information.

Now, in the most recent group-wide policy, your GCL, on April 30, you say that you will “maximize the sharing of information for risk management purposes amongst group companies and amongst global businesses and functions.” You have noted that HSBC is going to maximize the sharing of information to “the extent permitted by laws.” And that, again, is the rub.

What policies are you going to enact or implement to ensure that you provide law enforcement and governmental officials in this country which has given HBUS a charter—rather than using jurisdictional constraints as the excuse to avoid sharing information, what are you going to do with your new rules and regulations to make sure that this government and the proper authorities are given information upon request?

Mr. LEVEY. Mr. Chairman, as you indicate, we have committed within the company in the GCL to maximize the sharing of information for risk management purposes among our companies and functions. We have decided that is the value that we are going to pursue, which is that we need to share information. I think your report highlights the serious consequences that occur when we do not.

We have also decided through this policy that when there is—we are going to do everything we can to share information across borders. We have found, as you indicated in your question, that sometimes the secrecy jurisdiction was being used as a comfort, in a way. Well, no, we cannot share the information because of the jurisdictional rules.

It is my job as the Chief Legal Officer to look at that, right, and to try to work that out and make sure that we are not using it as an excuse. But in the end, of course, we have to abide by the law wherever we operate. That is true of any multinational company. All we can commit to do is—whenever there is any discretion, to exercise it in favor of sharing information. I do not know that we can do more than that or that any multinational organization can do more than that.

Senator LEVIN. Senator Coburn.

Senator COBURN. Ms. Dornier, in how many locales does HSBC now have operations that have such agreements as the Bahamas? In other words, what percentage of HSBC's locations throughout the world are tax havens or isolated places where jurisdictional differences preclude the sharing of information?

Ms. DORNER. I am sorry, Senator. I cannot actually put a number on that for you.

Senator COBURN. We have seen changes in Liechtenstein, for example, from pressure from this Subcommittee and others, where they have actually changed their laws. But could you get that to us?

Ms. DORNER. I am sure that we could. I think it is fair to say that all countries have privacy rules of one sort or another.

Senator COBURN. I understand, but we are talking about those countries that have privacy rules intended to not be transparent in the commission or the suppression of information that may or may not be, in fact, in the best interest of the global economy as a whole and may be associated with illicit activity.

Ms. DORNER. I understand. I am sure we could do that.

Senator COBURN. Thank you.

Do you know of any history in your experience where a bank charter has been pulled for cross-jurisdictional violations or what was perceived as a violation, but what was also perceived as in the best interest of your company as a whole or in the best interest of transparency in terms of fighting illicit activity?

Ms. DORNER. I am not aware of any.

Senator COBURN. OK. Thank you.

Back to Mr. Levey just for a minute. Do you believe there is sufficient oversight of the affiliates that make up the group compliance right now in your organization?

Mr. LEVEY. I think we are on the path to getting there, Senator, but I do not think I can sit here today and tell you that we are at the end of the road. I think we are at the beginning of the journey and we do have our work cut out for us, but we are on the right path.

Senator COBURN. As I said, I believe you have the best of intentions. This is not to question the new management at all, but I think some questions need to be asked. Do you know of any affiliates now that are not complying with the set standards?

Mr. LEVEY. Senator, I do not have knowledge of such a thing, but I also cannot sit here and tell you I am comfortable with the scope of this whole—

Senator COBURN. One further question along that line. If today you found out an affiliate that was not in compliance, what are the consequences?

Mr. LEVEY. The consequence is they would have to improve immediately, and the new thing, though, is that information would be shared with all other affiliates so that Ms. Dorner here in the United States would not be blind to it in the ways that we saw in the examples in the report.

Senator COBURN. You have powerful experience in the government and now applying that in the private sector. Do you have a recommendation for Senator Levin and I in terms of what we could do to make us both more effective, less burdensome, and more efficient as—even though you stated it is in your own best interest to be compliant, the point is, are there ways that we can help do that in a more efficient way that gets a better result.

Mr. LEVEY. I have to say, that sounds like a dangerous question. I did not come here to give you recommendations.

Senator COBURN. I have a reputation of being a straight shooter. I am asking that because I really want to know. I actually like to try to fix what is wrong with government rather than pile on another program that is supposed to do the same thing that is going to fail again. So if you would like to think about that and shoot me a short note, I would love to hear from you, but that was not meant in jest or as a trap—

Mr. LEVEY. No, I did not intend that.

Senator COBURN. It is my intent to try to make government work, and too often, it does not. Having been on both sides of the wall, you have a perspective that not many people have and I think you could offer us lots of suggestions on how we might be better at what we are doing, much like we have made recommendations in our report.

Mr. LEVEY. Well, I appreciate that, Senator. Of course, we have a lot to do to fix ourselves, but I do think that there are ways in which the sharing of information, which is the key here, right? The sharing of information is the key to these kinds of controls being effective and there are ways to improve that. There are changes that can be made in the way governments share information with the private sector and in which the private sector shares information amongst itself. That is ultimately what needs to be done. If we are going to really get these illicit actors, we are going to have to have better visibility. But I would be happy to try to follow up.

Senator COBURN. Thank you. Which would mean you need better information from us on illicit conduct. You need a more robust PATRIOT ACT in the areas of this illicit conduct. And you also need access to beneficial ownership information from us.

Mr. LEVEY. I agree with all of that.

Senator COBURN. OK. Thank you. Mr. Chairman, I yield back to you.

Senator LEVIN. I want to go back to the question about an affiliate that does not share information with you because of a local law that says that secrecy is the order of the day. These are the secrecy

jurisdiction entities, and Ms. Dorner, I guess you are going to give us how many of those jurisdictions there are affiliates in, is that correct? You were asked to do that and you are going to give us that for the record, I believe.

Now, you are committed to do a whole bunch of things. You are going to police the HSBC affiliates that use your accounts. You are going to audit so-called cover payments sent by HSBC affiliates to see if they are circumventing the OFAC filter. I think you prepared in your new approach to look at affiliates' internal audit findings to look for those with weak AML controls. I think you were just asked by Senator Coburn, what are you prepared to do if an affiliate does not provide information to you or to a law enforcement entity in a country that you have a charter, the United States.

I guess one of the ways you could enforce it would be to deny a U.S. correspondent account to an affiliate. Do you know whether or not that has ever been done? Has HBUS ever said no to an HSBC affiliate?

Ms. DORNER. The direct answer to your question is no, we have not. But we now have KYC at a level for all of our affiliates that we use for third parties and I can assure you that in the event that one of our affiliates did not pass the KYC as it stands now, I would have no hesitation in not opening an account or, indeed, closing an account.

Senator LEVIN. And what about if they do not share information with you? That was the question which I believe Senator Coburn was asking. Is not one of the remedies you just simply say, we are not going to let you have a correspondent account with us?

Ms. DORNER. The same rules would apply for any third party. If we asked for information and did not get it, we would close the account.

Senator LEVIN. But you will apply that test to an affiliate?

Ms. DORNER. We would.

Senator LEVIN. OK. Talking about secrecy jurisdictions and beneficial owners, I think you and I talked about this issue before, but let me get you on the record in this setting, Mr. Levey, and that is should the U.S. Government get the beneficial ownership information for U.S. corporations?

Mr. LEVEY. I believe so, Mr. Chairman, and it would also be helpful to banks—it would be helpful to us so that we could better know our customers because, as you know and you probably better than anyone, this is one of the obstacles that we sometimes face.

Senator LEVIN. That is very helpful and we will be sure to be quoting you for that in different places. [Laughter.]

I want to talk to you both about bearer shares. Bearer share corporations, so-called, are notorious vehicles for money laundering and for other illicit activity because they provide anonymity through assigning legal ownership of the corporation to whoever has the physical possession of its shares. There is no paper trail. There is no way of knowing who owns those corporations, just the way there is no way of knowing who is the real beneficial owner of a bank account unless we require people owning the accounts to tell us who the beneficial owners are.

But at times over the last decade, HBUS maintained over 2,000 bearer share accounts despite warnings by internal auditors and

outside regulators that the accounts posed high money laundering risks. Internal bank documents show the account owners deliberately pressured the bank to help hide their identities, and Exhibit 95<sup>1</sup> is one example of that, of a phone conversation between a man named Mauricio Cohen and an HBUS banker in Miami. I made reference to that in my opening statement.

I know that HBUS has reduced the total number of bearer share accounts, and I guess my question is why have any?

Ms. DORNER. Mr. Chairman—

Senator LEVIN. Could I interrupt your answer, and forgive me for this. I want to just read one thing to you before you answer, and that is what the World Bank has had to say about these bearer share accounts in its report last year. It said that no bank with any sort of due diligence standards is willing to conduct business with a company that has free-floating bearer shares. That is what the World Bank said. So, now, please.

Ms. DORNER. Thank you, Mr. Chairman. Entirely understand the concern with bearer shares, a matter of great concern to me. It is always very important for us to know our customer. We have changed our policy here in the United States. We have toughened it up. We do not really want to do this business. To the extent we do it at all, it is going to be done under very limited circumstances, only when we can hold the shares ourselves or get them into a custodial agent that we know so that we can actually understand the movement of the shares.

I think that because this is such a matter of general concern, the group—we are considering, or the new Group Standards Committee, on which I sit with Mr. Levey, they are looking, or we are looking at the U.S. policy with a view to extending that around the world.

Senator LEVIN. OK. That is really a step forward.

Another issue that I raised in the opening statement was HBUS's willingness to clear suspicious bulk travelers' checks for foreign banks. From 2005 to 2008, on a regular basis, HBUS cleared up to a half-million dollars or more a day in bulk travelers' checks from the Hokuriku Bank of Japan. They routinely arrived in large stacks of sequentially numbered checks signed and countersigned with the same signature, which was unreadable. HBUS found that the Japanese bank could not provide any "know your client" information or explain why two dozen of its customers were often depositing large stacks of U.S. dollar travelers' checks all purchased from the same bank in Russia, allegedly for the used car business people.

Now, this was under OCC pressure. HBUS stopped clearing the travelers' checks in 2008, but it kept open the correspondent account despite that Japanese bank's poor AML controls, and in less than 4 years, HBUS provided over \$290 million in U.S. dollars to a Japanese bank for the benefit of unknown clients dealing with unknown Russians who, again, were allegedly in the used car business.

<sup>1</sup> See Exhibit No. 95, which appears in the Appendix on page 1062.

So I guess the real question is, would that happen again? Would that correspondent account be kept open again under your new rules?

Ms. DORNER. Mr. Chairman, first, may I say I entirely understand the issue with travelers' checks and I have asked the AML Director immediately to do a full review.

As regards Hokuriku, they failed our new KYC standards in 2012, which is why we have closed the account, and I have now exited, or we have now exited 326 correspondent banking accounts since we instituted the new KYC procedures. And, therefore, I would hope that we would close any bank such as this because they would fail the new KYC procedures.

Senator LEVIN. A number of money laundering problems identified by the OCC in 2010 related to inadequate monitoring for suspicious activity. Among other problems, the failure to monitor for suspicious activity for the \$60 trillion in wire activity, failed to monitor the bank notes accounts held by its affiliates, used poor procedures to identify who could get enhanced monitoring, and a backlog of alerts that were not reviewed, and the OCC provided several pages of criticism related to the weak parameters that the bank used to review wire and account activity.

Now, one of the key provisions in that cease and desist order of the OCC in 2010 required HBUS to install a new AML monitoring system to replace its old one, called CAMP. The new one is called NORKOM, I believe, and the bank is supposed to ensure that it has useful parameters to identify potentially suspicious activity for review. Can you tell us whether or not that effort has been completed and whether you have fully met the requirements of the cease and desist order with respect to a new AML monitoring system?

Ms. DORNER. Thank you, Chairman. The whole point about the system, and this is, I know, why you are interested in it, the whole point about installing a system is it has to be absolutely fit for purpose. It absolutely has to fit the parameters of the business. It must identify the correct risks. And we must be able to monitor it.

We have installed NORKOM. It has been a huge investment. I would be the first to say that with all systems, as usual, improvements can always be made, and it has been pointed out to us that there are two ways that we need to improve this system. We entirely agree. We are on the front foot. We are taking these as a priority and we will fix it. I would imagine that we will be improving this system going forward forever because there are always new ways to fix these systems in such a way that they can deter illicit actors.

Senator LEVIN. As I understand the history here, when this was not working properly by the deadline of 180 days, rather than seeking an extension of the 180 days, the implementation plan was modified and then ended up in noncompliance with the consent order. Is that accurate?

Ms. DORNER. There are two MRAs that have been raised and they are very technical. They are very important because they are about the validation of the model and we will have to fix those two things. To the extent that the OCC have raised other issues, we

have replied in full and I believe that you have a copy of that letter.

Senator LEVIN. Is there a new deadline?

Ms. DORNER. There is not, to my knowledge, a deadline as such, but it is closely monitored and we are in day-to-day contact, literally, with the OCC, who are clearly very interested in getting this fixed.

[Pause.]

Senator LEVIN. OK. We have a vote on now, and I think what we will do is we will release this panel. We sure hope that you are going to carry out the commitments which have been made by this bank because our report raises just a lot of serious issues about international banking and this particular bank. Again, the bank has been cooperative, but we hope this visibility will actually help reform efforts at the bank.

Again, as I have said a couple of times this morning, we welcome the commitments. We welcome the apologies. It is the change in culture and actions which are critical. But there is that nagging question of accountability which others are going to have to judge. We are not in the prosecution business here. We are in the oversight business. Others will have to judge the accountability issues. But it has been significantly missing, not just in this situation, but generally in a whole lot of other banking situations and other situations in modern times. We hope that, somehow or other, the hearing and the investigation will also lead to some greater accountability.

But we will now release you and thank you.

Ms. DORNER. Thank you very much.

Mr. LEVEY. Thank you, Mr. Chairman.

Senator LEVIN. And we are going to stand adjourned for 10 minutes or until Senator Coburn gets back, whichever comes earlier.

[Recess.]

Senator LEVIN. The meeting will restart. I am told Senator Coburn will be coming back, but he told me we should start if he was not back, so here we go.

Let me now call on our next panel of witnesses, Thomas J. Curry, the Comptroller of the Currency; Grace E. Dailey, the former Deputy Comptroller for Large Bank Supervision at the Office of the Comptroller of the Currency; and finally Daniel Stipano, the Deputy Chief Counsel at the OCC.

Mr. Curry, I am sure this is the first time that you have appeared before this Subcommittee and we welcome you and look forward to your testimony.

Mr. Stipano, I believe you appeared before us about 8 years ago at our hearing on money laundering and foreign corruption.

Mr. STIPANO. Yes, sir.

Senator LEVIN. We welcome you back, and I think this is Ms. Dailey's first appearance here. We welcome you, as well. We appreciate all of you being with us and we look forward to your testimony.

I think as you have heard or are familiar with our rules, all witnesses who testify before this Subcommittee are required to be sworn, so I would ask that each of you stand and raise your right hand.



Do you swear that the testimony that you will give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. CURRY. I do.

Ms. DAILEY. I do.

Mr. STIPANO. I do.

Senator LEVIN. Under our timing system, you will get a red light a minute before a 5-minute—well, I guess now we are going to have a 10-minute testimony as the limit, so a minute before the 10 minutes is up, it will go from green to yellow and then you could conclude your remarks, and we would ask that you do limit your oral testimony to no more than 10 minutes. I believe, Mr. Curry, you are going to be presenting the statement, of course, for the OCC, so please proceed.

**TESTIMONY OF HON. THOMAS J. CURRY,<sup>1</sup> COMPTROLLER OF  
THE CURRENCY, U.S. DEPARTMENT OF THE TREASURY**

Mr. CURRY. Thank you, Chairman Levin, Senator Coburn, and Members of the Subcommittee. I appreciate the opportunity to appear before you today to discuss the OCC's work in ensuring compliance with the Bank Secrecy Act and the work we are doing to improve our Bank Secrecy Act (BSA) and AML compliance program.

The Subcommittee's staff report has identified important concerns with the activities of HSBC and with oversight and enforcement of BSA and AML requirements by the OCC in the case of HSBC. As I will describe below, we agree with the concerns reflected in the report's recommendations concerning the OCC and will fully implement those recommendations.

In one of my first speeches after becoming Comptroller of the Currency just a little more than 3 months ago, I highlighted the importance of BSA compliance. I also noted that this is an inherently difficult area. It requires banks to sift through large volumes of transactions to identify those that are suspicious, a task that is complicated by the ingenuity that criminal and terrorist elements bring to bear in finding new ways to conceal the true nature of their transactions.

In my speech on operational risk, I emphasized, and I want to reaffirm today, that no matter how difficult compliance is, I expect institutions we supervise to have effective programs in place to comply fully with the requirements of the BSA. We will insist on that.

Our testimony today provides details about the OCC's BSA and AML supervisory policies and practices. It further describes how the OCC monitors compliance with BSA requirements and ongoing supervision that we provide at the largest national banks and thrifts, as well as our current enforcement process when problems or concerns are identified through our supervision and our enforcement record for BSA.

As requested in the invitation to this hearing, our written statement also discusses our supervision of HSBC. In 2010, the OCC issued a comprehensive cease and desist order against HSBC. As

<sup>1</sup> The prepared statement of Mr. Curry appears in the Appendix on page 150.

our written statement details, with the benefit of hindsight, the OCC could have and should have taken this action sooner. But the issuance of this order does not conclude our activities with respect to the matters covered by the cease and desist order. We are now actively evaluating the bank's compliance with the order and considering the assessment of monetary penalties.

The Subcommittee's report contains three specific recommendations focused on the OCC's BSA/AML supervision. I agree with the concerns reflected in each of the recommendations and the OCC has begun taking actions in response.

First, we have already identified a new approach that we will implement to assure that BSA/AML deficiencies are fully considered in the safety and soundness context and are taken into account as part of the management component of a bank's CAMELS rating. We will direct our examiners to view serious deficiencies in a bank's BSA/AML compliance area, including program violations, as presumptively adversely affecting a bank's management component rating. We will also provide guidance on how to document application of this approach in determining the management component rating.

Second, we are revising and clarifying the operation of our Large Bank BSA Review Team to enhance our ability to bring different perspectives to bear and to react on a more timely basis to circumstances where a bank has multiple instances of matters requiring attention or apparent violations of the required components of its BSA/AML program. We will also explore how we track and review relevant information in this regard and whether new initiatives are appropriate in that area, as well.

Third, we will also revamp our current approach to citing BSA/AML violations to provide more flexibility for individual pillar violations to be cited and we will identify what steps we can take in our examinations to obtain a holistic view of a bank's BSA/AML compliance more promptly. One of the reasons for the current OCC approach is that it requires the OCC to focus on determining whether the deficiencies in a bank's program amount to a BSA compliance program violation, which requires a mandatory cease and desist order. Therefore, in implementing changes on this point, it will be important not to create disincentives to making the necessary tough calls when there are BSA compliance program violations mandating the issuance of a cease and desist order.

Finally, we will review other areas, such as training, staffing, recruitment, policies, and interagency coordination to make improvements in our BSA/AML supervision program.

I am joined today by Dan Stipano, Deputy Chief Counsel, and Grace Dailey, who served as the Deputy Comptroller for Large Banks from 2001 until November 2010. The three of us share a commitment to a rigorous BSA/AML supervisory and enforcement program at the OCC and we are continually seeking ways to improve our supervision in this important area.

I have asked Ms. Dailey and Mr. Stipano to introduce themselves to the Subcommittee, and then we will be pleased to answer your questions. Ms. Dailey.

**TESTIMONY OF GRACE E. DAILEY,<sup>1</sup> FORMER DEPUTY COMPTROLLER FOR LARGE BANK SUPERVISION, OFFICE OF THE COMPTROLLER OF THE CURRENCY**

Ms. DAILEY. Chairman Levin, Senator Coburn, my name is Grace Dailey and I have been with the OCC for 29 years as an examiner. I am currently the Examiner in Charge of a large bank in Minneapolis, where I oversee a team of examiners responsible for that bank's supervision.

From the end of 2001 through late 2010, I served as one of three Deputy Comptrollers in the OCC's Large Bank Division. In that role, I oversaw the supervision of a portfolio of large national banks. That portfolio changed over time, but included HSBC Bank USA, N.A., from July 2004 through November 2010. Prior to becoming Deputy Comptroller for Large Banks, I held a variety of roles supporting bank supervision, including serving as Examiner in Charge and other field positions in Minneapolis, Chicago, and New York.

I look forward to answering your questions.

Senator LEVIN. Thank you very much, Ms. Dailey. Mr. Stipano.

**TESTIMONY OF DANIEL P. STIPANO,<sup>2</sup> DEPUTY CHIEF COUNSEL, OFFICE OF THE COMPTROLLER OF THE CURRENCY**

Mr. STIPANO. Chairman Levin, Senator Coburn, and Members of the Subcommittee, my name is Daniel P. Stipano and I am one of two Deputy Chief Counsels at the Office of the Comptroller of the Currency. I have spent 27 years at the OCC, with the majority of that time working in enforcement and compliance. In my current role, I supervise the OCC's enforcement and compliance, litigation, community and consumer law, and administrative and internal law divisions, as well as the OCC District Counsel staffs in the OCC's Southern and Western Districts.

Prior to becoming Deputy Chief Counsel, I served as the Director for Enforcement and Compliance at the OCC, where I was responsible for taking administrative enforcement actions against national banks and their institution-affiliated parties. From 1989 to 1995, I was an Assistant Director in the Enforcement and Compliance Division after joining the OCC in 1985 as a Staff Attorney in the Division.

Senator LEVIN. OK. We thank you all.

Let us try 10 minutes for our first round of questions.

Let me start with a question for you, Ms. Dailey. You were the OCC Deputy Comptroller for Large Banks from 2001 to 2010 and were in charge of the OCC's supervision of a number of large international banks, including HBUS. When the OCC became HBUS's primary regulator in July 2004, the bank was already under a formal enforcement action by the Federal Reserve Bank of New York and the New York State Banking Department for having an inadequate AML program. As a condition for allowing HBUS to become a nationally chartered bank, the OCC required HBUS to complete all of the corrective actions set out in the written agreement that was the result of the enforcement action.

<sup>1</sup>The prepared statement of Ms. Dailey appears in the Appendix on page 150.

<sup>2</sup>The prepared statement of Mr. Stipano appears in the Appendix on page 150.

In 2006, the OCC determined that HBUS had fulfilled the requirements and terminated that agreement. Were you involved, first of all, in the decision to terminate the agreement?

Ms. DAILEY. I was one of the recommending officials. I was not the final decisionmaker.

Senator LEVIN. OK. Did you recommend that it be terminated?

Ms. DAILEY. Yes, I did.

Senator LEVIN. All right. Now, the Subcommittee has prepared a chart, Exhibit 1a,<sup>1</sup> that tracks the 44 AML examinations conducted by the OCC at HBUS from 2004 to 2010. As you can see from the chart in your book—you will not be able to follow that one, but it is also in your book—the OCC conducted seven exams before it voted to terminate the 2003 agreement in 2006. Those seven exams all took place in about 1 year, from 2005 to 2006, and identified 35 matters requiring attention, or MRAs, which are practices that the OCC defines as deviating from sound fundamental principles and “may adversely impact earnings or capital, risk profile or reputation,” or “result in substantive non-compliance with laws.”

First, are 35 MRAs, matters requiring attention, a high number for a bank to accumulate in 12 months?

Ms. DAILEY. Yes, it is a high number to accumulate in 12 months.

Senator LEVIN. So the 35 MRAs identified in those first seven examinations found that in most instances that the bank was not following its policies, was not monitoring properly, was not conducting appropriate due diligence, that written policies were not adequate, and that staff needed training, all of that while the bank was still under the 2003 enforcement actions. So all of those are matters that the Bank Secrecy Act specifically identifies as pillars or key components that a bank must have for an effective Bank Secrecy Act program. So how could that bank, with all of those outstanding problems in 2006, be considered to have an effective AML program?

Ms. DAILEY. Well, we did a lot of work in that time period, as you have pointed out by the chart, and we did find a lot of issues. Many of those issues—in fact, I think most of those issues—were corrected quite soon after they were detected. So some of the issues were not longstanding problems from the standpoint that it would take the institution a long time to fix, so they were corrected and when we made our determination, we went through the WSRC process. So it is a process to determine when we think a bank is in compliance with the articles, how to go about lifting that. Our examiners felt that the bank did have an adequate program at that time, was in technical compliance with the conditions, and we proceeded through our process, which is to take that through our WSRC process, which is members of management, and there was a recommendation and then a final decision was made. But I understand your concern that there were a lot of issues that were identified at that time.

Senator LEVIN. Well, there not only were a lot of other issues identified, but 23 of the 35 identified issues were also identified in four supervisory letters written in January 2006. Now, all four of

<sup>1</sup> See Exhibit No. 1a, which appears in the Appendix on page 575.

those supervisory letters were dated within 20 days of the decision, February 6, 2006, to terminate the agreement. So it is hard—I do not know how you can say that most of them had been dealt with, and then you have those four supervisory letters written within 20 days of the decision to terminate, and here are some of the issues that were listed in those four letters, again, within a 20-day period.

Monitoring problems were noted in all four letters. Policies in need of enhancements were cited in all four letters. Not following policies was identified in three of the four letters. Customer due diligence issues in three of the four letters. And staff in need of training in three of the four letters.

So I do not know how the OCC could rank and rate the bank's AML program as satisfactory and how they could cancel the enforcement action.

Senator LEVIN. I just do not understand it.

Ms. DAILEY. In hindsight, we should not have. From what we know today, they did not have an effective BSA program, and in fact, many of the problems that we detected in our 2009 examination were in existence during this time. So in retrospect and from what we know now, we would not have lifted those conditions.

Senator LEVIN. Well, but my point is that looking back now at what you knew then, it should not have been lifted, because what you knew then when you lifted it, 23 of the 35 matters requiring attention were still outstanding.

Ms. DAILEY. We probably did not appreciate the systemic nature of some of those issues. I understand the concern.

Senator LEVIN. Now, over the next 4 years, the MRAs or matters requiring attention did not stop. OCC examinations repeatedly found significant AML problems across a number of business lines, many of which were high risk and vulnerable to illicit activity. Fourteen of the examinations found AML monitoring problems. Eight found weak customer due diligence. Seven found insufficient staffing. Five found that the bank was not following its own policies. These problems existed in critical, high-risk business units such as banknotes, foreign correspondent banking, embassy, banking, international and domestic private banking, wire transfers, and pouch services. By 2009, HBUS had 83 MRAs, more than any other national bank. The next closest had 20 fewer.

So with this kind of a record, the first question that one wonders is why the OCC never took formal enforcement action against HBUS prior to 2010. Do you know why it did not?

Ms. DAILEY. Stepping back and looking at it, we should have. We could have and we should have taken action sooner.

Senator LEVIN. I am talking about formal enforcement action, right? That is what we are talking about.

Ms. DAILEY. Yes. I agree that we could have and should have taken formal enforcement action. With the benefit of hindsight, we should have.

Senator LEVIN. Well, these words are the benefit of hindsight. Given what you knew then, should you not have taken enforcement action?

Ms. DAILEY. Had we applied the process that we plan to apply going forward, which is to have the flexibility to cite pillar violations, we would have cited pillar violations in these instances and

we may have drawn a different conclusion then to cite a program violation.

Senator LEVIN. What about informal enforcement action? Was there any informal enforcement action taken against HBUS prior to 2010?

Ms. DAILEY. There was not.

Senator LEVIN. This is pretty feeble enforcement. Mr. Curry, what do you think about this record that you inherited?

Mr. CURRY. I would like to see going forward a much more aggressive posture by the OCC. If there is evidence of material weaknesses in a BSA/AML program, I would like to see, at the very least, a progressive remedial program being instituted and to use all the tools that are available to us, including cease and desist orders.

Senator LEVIN. Did the OCC ever cite a violation of law for non-compliance with AML statutes prior to 2010? Do you know, Ms. Dailey?

Ms. DAILEY. I do not believe we did prior to 2010.

Senator LEVIN. Mr. Stipano, you are the Deputy Chief Legal Counsel for the OCC. You told the Subcommittee staff that you did not have much involvement with HBUS prior to 2009 because the Supervision Division was responsible for examinations and the Legal Department generally gets involved only in enforcement actions, investigations, or legal actions brought against the bank by the Supervision Division. But in the spring of 2009, the OCC was contacted by two Federal enforcement agencies regarding investigations that they were conducting of possible money laundering, going through accounts at HBUS, and the OCC met with representatives of those agencies in Washington, DC, on September 1, 2009. When the meeting concluded, the OCC staff continued to discuss the HBUS situation. Was it at that meeting that you learned for the first time about the findings of previous AML exams of HBUS and that they had resulted in 83 MRAs?

Mr. STIPANO. To the best of my recollection, that was the first time that I learned about the 83 MRAs.

Senator LEVIN. Had you encountered some of the problems at HBUS before that?

Mr. STIPANO. Yes. One situation I remember, and I do not have a date on it, was the agency was contacted by two former HSBC employees who were essentially whistleblowers and they had concerns about the way that the bank was managing its embassy banking business. At that time, I directed the Director of Enforcement to meet with Ms. Dailey, to set up a meeting and to have them come in and interview them and find out what the basis of their concerns were. That meeting did take place. I was not personally a participant. Following that, an examination was opened into the embassy banking area and I believe that findings were made and that supervisory actions were taken as a consequence.

Senator LEVIN. When you learned that there were 83 MRAs that were specific to the Bank Secrecy Act, were you surprised by the number?

Mr. STIPANO. Yes.

Senator LEVIN. And did you also learn that there had been two recommendations that cease and desist orders be issued against HBUS?

Mr. STIPANO. I did learn that, but I do not recall whether I learned that following that meeting or if I learned that subsequently. But I was not aware of that, to my knowledge, prior to that meeting.

Senator LEVIN. Did anyone ever explain why the Supervision Division never tried to elevate the issue and take some kind of regulatory action?

Mr. STIPANO. I do not recall anybody explaining that to me. I think that judgments were made by bank supervision that the matter did not rise to the level of warranting a cease and desist order or another enforcement action up to that point.

Senator LEVIN. And what was your reaction to that?

Mr. STIPANO. I was very concerned. I think that learning what we learned both through our discussions with the law enforcement agents and what we learned from the examiners following the meeting, it was apparent to me that there was a serious problem in the BSA/AML area and that it needed to be addressed promptly.

Senator LEVIN. Did you start an investigation in which both the Legal and Enforcement Divisions got involved at that time?

Mr. STIPANO. Yes. I do not have precise dates, but shortly—

Senator LEVIN. About that time?

Mr. STIPANO. Yes, shortly thereafter.

Senator LEVIN. And did you then expand an ongoing AML exam? You set time tables, secured an order of investigation, helped craft the two supervisory letters to HBUS in 2010 which were the first to cite the bank for violations of AML laws and OFAC regulations? Did that happen?

Mr. STIPANO. Yes, but there was an ongoing examination into the banknotes area, and this was something that the agency became concerned about following an enforcement action at Wachovia that concerned banknotes and bulk cash services. So the examiners were already looking into it, but I think that the consequence of the meeting with law enforcement and the information that we obtained at that time was to expand the examination and open a formal investigation.

Senator LEVIN. Why did the Legal Department and the Enforcement Department have to get involved before some regulatory action was taken? Was that ever explained to you?

Mr. STIPANO. I think that if we are talking about actually doing an investigation or taking an enforcement action, that really cannot be done without the participation of lawyers. Our investigations involve issuance of subpoenas, subpoenas for documents, and subpoenas for testimony. It is not something that examiners can do on their own, and the same thing with our enforcement actions. The document is a legal document. It is legally enforceable. The respondent bank or individual has due process rights. So the Legal and the Enforcement Division need to be involved.

Senator LEVIN. But apparently, your level and the enforcement folks were not contacted until after the OCC was contacted by law enforcement agencies in the midst of a criminal investigation involving the bank. So you had all of this background, having all of

these unresolved issues, important issues, but yet you were not contacted and you just point out how important it is that the Legal Department and the Enforcement Department be contacted before some regulatory action was taken. But until that time, with all of the problems that were identified in the exams, which had been recurring and mounting for years, it did not reach your level, is that correct?

Mr. STIPANO. That is basically correct. I mean, there could have been incidental contact. There could have been discussions. There is a senior counsel of the Law Department who works for me that is on the Large Bank Review Team. His role in that capacity is to review supervisory letters and conclusion memos. So it was not like nobody in the Legal Department ever spoke to anybody in Large Banks. But in terms of actually getting a referral or being brought in in order to conduct an investigation or take an action, that did not happen prior to 2009.

Senator LEVIN. So, Mr. Curry, this was not a case where OCC examiners failed to do their job, by the way. They were identifying the AML problems at HBUS all along the way. The higher-ups were overly passive. They were waiting until the problems grew into a very huge one before taking any action, before there had to be criminal investigations that were begun, before there was any real referral to the enforcement folks or the legal folks.

Now, you are new there. You are only there a couple months, so you may not know the answer yet to this question, but when a bank is exhibiting the kind of problems that this bank showed, the problems that continually occur in multiple business lines, do you not believe that the OCC should take some type of regulatory action before those problems become so great that they are the subject of a criminal grand jury, for instance?

Mr. CURRY. One of the most troubling aspects of the Subcommittee's report really is the issue of our ability to identify and act upon the cumulative effect of BSA/AML deficiencies and that is an area that I would like to see much greater clarity as to the posture of enforcement at the agency, and also is the rationale for the expansion of the Large Bank Review Team's mandate to actually be the vehicle to look at the entire compliance posture of our largest institutions to take a holistic view and to react accordingly.

Senator LEVIN. Are you ready, Senator Coburn?

Senator COBURN. Yes.

Senator LEVIN. OK. Senator Coburn.

Senator COBURN. I apologize for being absent during your opening statements and your questions, so if I get ready to repeat a question that was already asked, I hope you will stop me.

Senator LEVIN. Well, you may be getting a better answer. One never knows. [Laughter.]

I think the answers have been responsive. I should not suggest otherwise.

Senator COBURN. This is for Mr. Curry, how do you respond to the charge that the OCC, by giving such high scores to HSBC for so many years, became an enabler because it gave false comfort?

Mr. CURRY. I think, again, judging on what I am familiar with, the Subcommittee's record and from the information I have determined as Comptroller, the agency has been much too slow in re-



sponding and addressing what are significant weaknesses or violations at this institution. And going forward, I would hope that we would be much more nimble and take into account the entire picture, what we are looking at in terms of compliance.

Senator COBURN. Knowing what you know now, I mean, what this Subcommittee's report has exposed and what also was known by you at times, is it a matter of being nimble and more responsive, or is it a matter of competency?

Mr. CURRY. I believe it is really a matter of being more nimble and recognizing the importance of BSA/AML compliance as both a national interest and in terms of it being a significant and serious safety and soundness issue. And my hope is that, going forward, we will react accordingly, which requires direct and progressive remedial action as supervisors.

Senator COBURN. So have some of those actions taken place now?

Mr. CURRY. Yes. We have begun to already implement the specific recommendations of the Subcommittee. We are also taking an independent look at how we recruit, train, our policies, and also how we can improve our coordination with both our fellow bank regulatory agencies and with law enforcement agencies. This is an opportunity for us to look at the big picture of how we are implementing our responsibilities under the Bank Secrecy Act and AML statutes.

Senator COBURN. This kind of reminds me, but on a much larger scale, of the Homeland Security Oversight Subcommittee and Federal Financial Management Subcommittee in terms of the Defense Audit Agency. And what we found there is they never hired new blood. It was all promoted from within. And the vast majority of those auditors never had real experience auditing, and so you kind of got a downward trend of the least favorable aspects as they promoted people with lesser and lesser experience and no variety of their experience.

How do you go about hiring people now?

Mr. CURRY. It is a challenge to obtain people with the requisite skills that you need to assess bank operations and the specific legal requirements and regulatory requirements of the BSA and AML. That being said, I am committed in renewing a real effort to attract competent personnel from both within and outside the agency.

Senator COBURN. Would not one source be people who have been very good at figuring out how to duck your issues and having them work for you?

Mr. CURRY. Yes, and that is part of our training. We do seek to understand or have presentations by individuals who have experience with how the criminal element exploits our Bank Secrecy Act and AML—

Senator COBURN. Well, I was not talking about the criminal element. I was talking about the people who were on the other side on compliance in terms of recruiting them.

Mr. CURRY. Yes, that would be a source of personnel.

Senator COBURN. A lot has been said in our report about HSBC allowing drug cartels and terrorists to move money through its banks. Since you all knew all of this was happening and did not stop it, are you not somewhat complicit in it?

Mr. CURRY. I deeply regret that we did not act sooner and more decisively.

Senator COBURN. So is that a yes?

Mr. CURRY. Yes. Absolutely.

Senator COBURN. This is a little harder question. Take a little bit longer time. But with as much specificity as possible, can you explain what a good AML system within a bank should look like? And I am not talking about pillars or principles. I am talking about the actuality of what a bank—what would you all ideally—I know what your regulations say. I know what we have recommended. What would you, if I came to you and I had a 150-bank operation and it is international and I said, what should my AML look like, what would you tell me?

Mr. CURRY. I think the No. 1 principle or attribute would be having management and the board being committed to developing and funding a BSA/AML program that was appropriate for the business activities of that institution. That is probably the No. 1 thing. And then in a successful program, all other requirements would flow from that—hiring competent personnel with the requisite experience to implement a credible program, building the management information systems that are necessary to monitor BSA/AML activities, as well. And at the end of the day, it is a corporate commitment to compliance.

Senator COBURN. Did you happen to hear Ms. Dorner and Mr. Levey's testimony today?

Mr. CURRY. I was able to hear the tail end of their testimony.

Senator COBURN. Do you think they have put in place a good AML system?

Mr. CURRY. That is our expectation as their primary supervisor.

Senator COBURN. But based on what they said here today, is it your belief, if they carry out what they have said here today, that they will have a great AML system?

Mr. CURRY. I would hope that is the case. I think we are in the position as their supervisor that we need to verify that and I do not believe we are in a position to do that right now.

Senator COBURN. OK. So how do you know when somebody has a good AML system?

Mr. CURRY. Personally, as the Comptroller, I am relying on the expertise and the supervision programs of our examinations staff.

Senator COBURN. And so who directly under you is responsible for that?

Mr. CURRY. The Senior Deputy Comptrollers of both our Large Bank Division and our Mid-Size and Community Bank Divisions are the primary people responsible for our BSA examination programs. We also have, which Mr. Stipano mentioned and I mentioned in response to an earlier question, a Large Bank Review Team, which is really the Washington-based clearing function for making sure that there is coordination and consistency within our supervision programs, and especially in the area of enforcement.

Senator COBURN. I would be interested if you would get the videotape of Ms. Dorner and Mr. Levey and share with the Subcommittee your thoughts in terms—I know you have to prove and make sure, that is your responsibility, but I would love to hear your thoughts about what they said they were doing, how they

were doing it, how they were implementing it, how they were doing clawbacks, how they were holding people accountable, and how they were trying to change the culture within their organization.

Mr. CURRY. I would be happy to do that, Senator, and to get back to you.

Senator COBURN. Thank you.

Ms. Dailey, our investigation found in 2007 that examiners recommended the OCC take formal enforcement action against HBUS for weakness in how it monitored how its pouch services report. That is on page 304. But the OCC decided to take no such action. Do you recall that?

Ms. DAILEY. To the best of my recollection, that recommendation did not reach me.

Senator COBURN. OK. Do you have any idea how high up it got?

Ms. DAILEY. Generally, what would happen is an examiner would make a recommendation and present that to an Examiner in Charge. I do not know if that happened or not.

Senator COBURN. Well, that would seem to suggest to me that some of the same problems are going on at the OCC that were going on at HSBC. We heard testimony from our first two panels of what was not happening, where information was not flowing that should be flowing, some of it for profit motive, some of it from incompetence. Is it possible that line-level examiners thought a tough enforcement action was needed but were overruled by their supervisors?

Ms. DAILEY. I do not know that. I do not have any knowledge to that effect because it did not come to me. It could have been presented to the Examiner in Charge and they could have made a different determination once looking at the facts. Oftentimes, when the examiners make determinations, they sit down with the Examiner in Charge and go through the different criteria and the different facts and they could come to a different conclusion. I do not know that, though, because I was not part of any of those types of discussions.

Senator COBURN. All right. And it is easy for us to arm chair quarterback it now, looking backwards, and I understand that.

Does the agency or did the agency have any processes in place to make sure all proper enforcement actions were handled consistently across the various banks that OCC regulated?

Ms. DAILEY. Yes. We have what we call a WSRC process in place, and what happens is whenever an enforcement action, whether it is informal or formal, is recommended, it goes through the examination team. It would be presented to the Large Bank Review Team. If the Large Bank Review Team agreed with those findings, it would be presented to the WSRC committee, and that committee is made up of members of across our agency in supervision, policy, enforcement, etc., and that committee is a recommending body for an informal or formal action and the final decision would be made by a Senior Deputy Comptroller.

Senator COBURN. So as you look back through the past few years, where do you think you all have failed? I mean, just an honest assessment of where was our management not good? Where was our quality of instruction and direction, where were our employees not up to the task? In other words, we obviously had a great big prob-

lem here. Everybody agrees with that. So from just your viewpoint, where you sit, where do you think the problem was?

Ms. DAILEY. I think we did a lot of work. We did a lot of examinations. We found a lot of issues. We received some corrective action along the way. But we did not probably step back as well as we should, and with the benefit of hindsight, we could have and should have taken action sooner.

Senator COBURN. Mr. Chairman, that is the kind of answer we get all the time. The fact is, is what that means is things are going to be repeated, and what our whole goal is, is so that things are not repeated.

Mr. CURRY. Senator Coburn, I think from my perspective as Comptroller, I really want to address the same issues that you asked me to look at how HSBC was addressing. I want to have a culture at the OCC in which examiners feel free to voice documented, well founded concerns about the performance of the banks that they are examined, to know that those concerns are going to be fairly and thoroughly reviewed, and at the end of the day, the appropriate action or, in some cases, inaction will be taken by the agency as a whole.

Senator COBURN. So what happens right now when an examiner feels strongly that some action needs to be taken and the person in charge of that examination disagrees? Where is the outlet pressure for somebody to appeal without it costing them?

Mr. CURRY. I would encourage them and they have the opportunity to appeal to me. We also have review functions, whether it is in the case of BSA and the Large Bank Review Team, or to contact our Committee on Bank Supervision or any one of the senior members of the agency.

Senator COBURN. So how many times has that happened?

Mr. CURRY. In my short tenure, I am not aware of that number.

Senator COBURN. Has it happened? Has anyone called you?

Mr. CURRY. No one has called me specifically, but I want to create a culture at the OCC, or to reinforce a culture that we are here to be bank supervisors and that we are to be fair and reasonable in how we approach that. But at the end of the day, we are to do what we are being paid to do.

Senator COBURN. All right. I have gone over time. It is yours.

Senator LEVIN. How many months have you been there?

Mr. CURRY. A little over 3 months.

Senator LEVIN. All right. Well, I would believe that in the next 3 months, you will be getting some phone calls and it is important that line of communication be kept open, that people be able to appeal denials of their strong urgings after notifying their supervisor that they are going to do it. You have to be able to go around your supervisor, and if they do it privately, without notice to the supervisor, I guess they would become a whistleblower at that point and they have to be protected under our whistleblower laws because the stakes here are just too huge and the failures here are too massive to allow them to be repeated.

My own belief is that part of the reason has been a culture, but the other part is that there has been just a lack of accountability. It was true, at least, inside this agency.

This is not a matter of hindsight, by the way. I would disagree with you here, Ms. Dailey. This is where at the time things were known and were not acted on. And that is what is so troubling here. We obviously want to use hindsight to improve. We always can use hindsight to benefit us. But what we have seen throughout this hearing today is that at the time, contemporaneously with these events, that there were people who knew better. There were sometimes efforts made that were ignored and squelched. But it is not just a matter of with the benefit of hindsight here.

The testimony that you have given us today, Mr. Curry, is that the agency is reviewing the matter in which MRAs are reported to ensure that banks with high numbers of MRAs will receive additional supervisory attention and consideration of formal enforcement action and I would like to get some additional details on this matter, who is going to be involved in this revised approach, looking at matters requiring attention when there are a number of these that are issued. Who is going to be looking at it, just supervision, or are the Legal and Enforcement Divisions going to be in the mix? Give us some details on how this is going to work.

Mr. CURRY. Initially, we are looking to expand the mandate of our Large Bank Review Team to take on that function. That is our initial response to the report's findings. My hope is that we will have additional recommendations after we look at this matter further, as we examine our policies and procedures. There may be a more effective measure that we will employ. In any event, I will endeavor to keep this Subcommittee informed of the improvements that we will be making on an ongoing basis.

Senator LEVIN. So that the enforcement folks and the legal folks are going to be involved in this new process early?

Mr. CURRY. That is the intention.

Senator LEVIN. Is the revised approach going to have some sort of thresholds that they are going to apply, maybe to different time frames, such as how many MRAs in a month, how many MRAs in a year, and so forth?

Mr. CURRY. I cannot say that we will come up with an arithmetical floor, but we will have a process that looks at the totality of circumstances of which the number of MRAs will be a critical factor.

Senator LEVIN. The Subcommittee investigation found that in some instances, the conclusion memos of exams at HBUS were a lot stronger than the supervisory letters that were sent to the bank. So in those instances, the real message about the seriousness of problems was not being delivered to the bank. Is your Large Bank Review Team going to get better information now than in prior years?

Mr. CURRY. That particular practice has already been corrected. Both the conclusion memo and the supervisory letter draft will be reviewed by the Large Bank Review Team.

Senator LEVIN. I am also encouraged by your testimony today and by the OCC's willingness to look for ways to improve the exam supervision, and here is what our report noted, that there are some practices at the OCC that depart from the practices utilized by other Federal bank regulators, and more importantly, seem to act as a barrier to your examiners, your AML examiners. Those bar-

riers made it difficult for your AML examiners to get the appropriate attention of their supervisors when AML problems were quite evident. In your testimony, you acknowledge that your agency does differ from other agencies with respect to including AML exam findings in the consumer compliance exam process and you are going to correct that.

By the way, has anyone explained to you exactly why the anti-money laundering was inserted into customer compliance examinations and ratings? That was a longstanding process. It did not occur by happenstance. We are delighted today to hear that you are correcting that. Your testimony is very clear on that, that you are going to now follow the same practice that other examiners do in this regard.

But was it ever explained to you why it was part of the customer compliance ratings?

Mr. CURRY. I did ask why we deviated from the other Federal bank regulatory agencies in that regard. Personally, my view is that BSA/AML is a significant or serious safety and soundness issue and that it is appropriately addressed by looking at it in the context of the management component in the CAMELS rating system and that policy has been adopted at the agency already and we are simply in the process of communicating that decision and making appropriate changes to the examination procedures for our staff.

Senator LEVIN. And when will the new AML exam process take effect? Will it take effect immediately?

Mr. CURRY. It is immediate. There will be some lag in communicating the actual procedures to staff, but we will, again, keep you informed on that process, if you would like.

Senator LEVIN. So the exams are going to be considered this year when assigning CAMELS management ratings?

Mr. CURRY. Yes, as soon as possible. I would expect it to be sooner rather than later.

Senator LEVIN. A matter of months?

Mr. CURRY. Yes. Less than that, hopefully.

Senator LEVIN. Good. Might this have implications for the current rating at some banks, including HBUS?

Mr. CURRY. I believe our position is that serious and significant BSA violations should be presumptively a factor in an adverse management rating.

Senator LEVIN. All right. And if it applies, if it has an impact on HBUS, so be it?

Mr. CURRY. So be it.

Senator LEVIN. The Subcommittee report also recommended that the OCC cite violations when a bank fails to meet any one of the statutory minimum requirements for an AML program. You state in your testimony that the OCC is going to "revisit its current approach in order to provide more flexibility for individual pillar violations to be cited." Can you give us just a little bit more detail on what you mean by "revisiting our current approach"?

Mr. CURRY. We are looking to broaden the range and types of violations that examiners will be reporting in the reports of examination and in supervisory communications. The only reservation that we stated was we want to make sure that where there are

program violations, that is clear that they will result in a mandatory cease and desist order.

Senator LEVIN. OK. Senator Coburn.

Senator COBURN. Just a few more questions. Ms. Dailey, in September 2009, OCC officials, including you, met with officials from DHS, Immigration and Customs Enforcement who were investigating money laundering. After the meeting, the lead AML examiner for HBUS said he had twice recommended cease and desist orders against HBUS for AML weaknesses. Do you recall that?

Ms. DAILEY. I recall the meeting afterward and I recall the gentleman discussing the MRAs. I do not recall whether he discussed or mentioned that there had been previous recommendations or not.

Senator COBURN. Yes. So you cannot tell me whether that was an accurate statement he made to us?

Ms. DAILEY. I do not recall that part of the conversation.

Senator COBURN. Well, Mr. Stipano, a memo following that September 2009 meeting states that when learning of the cease and desist recommendations that were not followed, you said you were unaware of the recent history of HBUS and that you requested the thorough review. Is that right?

Mr. STIPANO. Yes. My recollection, and Senator Coburn, we did talk about this a little bit when you were out of the room—

Senator COBURN. All right.

Mr. STIPANO. But my recollection of it was that following the broader meeting with law enforcement, we had a smaller internal meeting and I learned at that point for the first time about the 83 MRAs. I do not recall whether I also learned at the same time that there had been past recommendations for cease and desist orders. I did learn that at some point subsequent to that. It could have been at that meeting. It could have been later. I just do not remember.

Senator COBURN. But the fact is, there were recommendations made for cease and desist orders from examiners, correct?

Mr. STIPANO. We know that now.

Senator COBURN. Yes.

Mr. STIPANO. Yes.

Senator COBURN. So back to Mr. Curry. Here is a prime example where recommendations were made and got squelched, essentially. Somebody made a decision that it was not going to happen. To me, I would use that as one of the learning models. Here is what we do not want to happen in the future, so here is how our policies and procedures are going to make sure this does not happen, because you obviously had a problem. Everybody agrees there was a problem. The examiner made probably the right recommendation, except nothing happened on it. The whole purpose of this is to learn, to get better, and to make the changes so that does not happen. Any disagreement with that?

Mr. CURRY. No, none at all, Senator Coburn. I think it is important as a supervisor that when we detect significant weaknesses in any program, particularly BSA/AML, that the sooner that we take appropriate remedial action or corrective action, the better all of us are, both the institution, the agency, and the public.

Senator COBURN. You made an offer to communicate with this Subcommittee on your progress. I would hope that as you do that, that situations like this are specifically addressed. Here is what we have done to make sure that this does not happen. Here is the policies and procedures. And I know this is not easy stuff that you are tasked with. Let me say I understand that. But it also is not rocket science and key management metrics and culture change to where somebody can scream, something is going wrong here, and it is heard all the way to the top.

Mr. CURRY. I agree with you completely, Senator Coburn. It is also clear that, from the top, that we be clear as to what the objective is and what the expectations are, and that is something that I intend to do, and to do forcefully.

Senator COBURN. All right. I think my staff tells me the rest of this has been pretty well covered by you. And you have talked about the conflict of interest on bank examiners, on examiners while I was gone?

Senator LEVIN. No.

Senator COBURN. Well, let us just do that for a moment. Earlier this month, the Treasury Inspector General released a report detailing significant ethical breaches by an OCC national bank examiner. And I will not go into what those are, but the breaches occurred at times when he was supposed to be examining their bank and he was off doing something else other than that. Also, it was noted that he was dishonest on time sheets, etc.

Based on this one finding, have you had time to look into this and to say, is this an isolated incident or is this occurring more than we might think, and does this put our examinations at risk?

Mr. CURRY. This particular conduct, which I just recently became aware of, is totally unacceptable and reprehensible conduct by a bank examiner, and what I find particularly troubling is the potential for disrepute that it places on the many fine people, the 3,600 people who work for the OCC. That is not our standard of ethical conduct. We take great pains to advise and to educate our staff about what conduct is expected from a bank examiner, particularly given the significance of their duties as examiners. So it is troubling to me.

The preliminary information I have been able to gather from the Treasury IG data is that this appears to be a very isolated case. There were only six cases that were reviewed by the IG. And I might add that in this particular case, the agency itself referred it to the Inspector General of the Treasury to investigate. But only three of those six had any merit, and that was over a 3-year period. That is not the conduct that I or my colleagues at the OCC expect of an examiner.

Senator COBURN. It speaks well for you, because the complaint was initiated by one of your other examiners and so there was responsiveness on the part of the OCC to that complaint.

Mr. Chairman, I yield to you.

Senator LEVIN. Thank you very much, Senator Coburn.

Just a few more questions from me. The question was raised with the earlier panel about whether HBUS is complying with the 2010 cease and desist order which was issued in October of that year. Article 9 of the order required the bank within 180 days to



install, test, and activate a new wire transaction monitoring system. I understand that there was a supervisory letter which was written by the OCC on May 25 of this year informing the bank that it was not in compliance with the order and you identified two MRAs that instructed the bank to address deficiencies. The two MRAs instructed the bank to implement an effective AML automated monitoring system and an effective automated alert risk scoring prioritization function to identify the more important alerts.

They were supposed to do that in 180 days. It is now 2 years later. Are the bank's deficiencies in how it is monitoring for suspicious activity a problem as far as the OCC is concerned?

Mr. STIPANO. Chairman Levin, you are correct that the OCC did recently issue a supervisory letter that cited the bank for non-compliance with an article of the cease and desist order concerning their automated monitoring system for wire transfers. That is a matter that we are currently reviewing along with other current examination findings and will be taken into account in any subsequent enforcement actions that we may take.

Senator LEVIN. Now, another article of the consent order required that the bank retain one or more independent consultants to conduct an independent review of account and transaction activities, a so-called look back, to determine whether suspicious activity was timely identified by the bank and, if appropriate, suspicious activity reports were timely filed with law enforcement. Are you satisfied that the requirement has been met?

Mr. STIPANO. My understanding is that we are presently looking at all areas of potential noncompliance with the cease and desist order and we are in a process right now of making some determinations and we will take appropriate action.

Senator LEVIN. Article 8 of that order required that the bank develop and implement appropriate policies and procedures for gathering customer due diligence for new and existing accounts. As part of that requirement, the OCC directed HBUS to identify accounts opened for offshore banks, in other words, for banks with a license that prohibits them from conducting banking activities with citizens of or with the local currency of the country which issued the license. I understand that the bank identified having accounts for 57 offshore banks, of which it will close 23 and keep 33. Has the OCC reviewed that effort, and how high of an anti-money laundering risk is attached to those 33 banks?

Mr. STIPANO. Chairman Levin, I am really not in a position to discuss details of the bank's compliance beyond what I had said earlier. We are in the midst of a civil money penalty proceeding. We will be looking at the total record of compliance with the document in making our determinations.

Senator LEVIN. Also, will you give us for the record, then, also whether you have reviewed these accounts where there is a so-called politically exposed person because in your order you required that the bank's "know your customer" program identify and conduct an enhanced due diligence review of all accounts opened for political figures, which are referred to internationally as politically exposed persons. Will you give us for the record the status of that effort?

Mr. STIPANO. I cannot report on the details. I can tell you that our examiners, our supervisory staff, and our enforcement attorneys, are very much focused on the level of compliance with our document. We will do a thorough review and we will take appropriate action.

Senator LEVIN. And will you let us know what that leads to?

Mr. STIPANO. Yes, sir.

Senator LEVIN. Has HSBC established an effective program to identify the beneficial owners of any bearer share accounts?

Mr. STIPANO. I think that is something that we need to determine.

Senator LEVIN. OK, and you are going to let us know that?

Mr. STIPANO. Yes, sir.

Senator LEVIN. Why should banks open accounts for bearer share corporations? Maybe I should ask you, Mr. Curry. Or any one of you can answer it.

Mr. CURRY. Given the high-risk nature of those accounts, I do not know.

Senator LEVIN. Will you take a look at that whole issue because it sort of continues. They have said they have taken some steps, and I take their word for it. The steps that they identified this morning were that they are going to hold those shares in escrow or put them with an agent, I believe they said, who would be a reliable agent. But there is a waiver provision in there and that waiver provision is an easy loophole, I am afraid. I did not ask the panel about that at the time. I forgot to do that, and I can ask that for the record, as a matter of fact. But take a look at that issue and see whether or not the loophole in that new step that they are going to take is acceptable to the OCC.

Mr. CURRY. Yes. I would expect that would be a focus of our ongoing supervision.

Senator COBURN. Mr. Chairman, I would just add one point. It is interesting. We have already established the fact that there was some complicity with OCC and HSBC. But there is some irony in the fact that this organization that is now going to fine them, I wonder who is going to fine you?

Mr. CURRY. No, in terms of accountability, I am accountable and I will hold myself accountable and I know you will hold me accountable. Also, I want to emphasize that the vast majority of the people at the Office of the Comptroller of the Currency, particularly the supervisory personnel, are committed. They are very proud to be commissioned national bank examiners and that pride—we will appeal to that pride to make sure that it is evident in the work that we do going forward.

Senator COBURN. I guess my point is, is there is no financial consequence when we have an agency responsible for something and yet fails, but there is a financial consequence to the people that were regulated by the agency that actually failed to do what the agency was supposed to hold them accountable not to do. That was the only point I was making.

Senator LEVIN. I agree with that and I also agree that Congress has responsibility, too, in our oversight.

Senator COBURN. And that is why we are here.

Senator LEVIN. That is exactly what this Subcommittee is about and other committees and subcommittees are involved in and should be involved in. The oversight function is critically important and that is our responsibility, to bring about accountability through oversight. But it has been missing in many places and in many places where it deserves to be applied. That is one of the results, I hope, of these hearings and what our Subcommittee has tried to do over the years is to promote accountability wherever it needs to be achieved.

I do not have any further questions. Do you have any further questions, Senator Coburn?

Senator COBURN. No.

Senator LEVIN. Let me just summarize very briefly, and that is that we have seen today what the problems are, and our staffs, both of them working together so beautifully as they do, have put together a powerful report, a compelling report and it speaks for itself, but we have tried to summarize the best we could here today.

HBUS and HSBC have made commitments to improve in a number of ways. They have improved by a big increase in the number of compliance personnel. The compliance resources have been increased. The affiliate due diligence requirements that they are putting in are extremely important. They sure were missing in the history so far. They have closed 325 correspondent accounts, including those accounts of 55 banks in sanctioned countries, such as Iran, Syria, and North Korea. They closed the Cayman accounts, and that is a real beginning of some action against these kind of hidden accounts kept secret from the world that can be put to such dubious purposes as we have seen here today. We have seen, in other words, the beginning, we hope, of the cleanup of this global bank, and if it happens, it is going to strengthen protections for people in countries around the world.

The OCC has agreed to strengthen its anti-money laundering oversight. It is going to treat the failures as safety and soundness problems, not just consumer compliance problems. That is going to have a very strong impact and a deterrent impact on our banks. It will cite statutory violations for banks that fail to meet the requirements for the four mandatory components of an AML program. It has agreed as part of its strengthening of anti-money laundering oversight to have a large bank review whenever a bank hits a threshold of a certain number or approximate number of MRAs or violations.

So if everybody carries out the violations—excuse me. If everyone carries out the commitments—they have already carried out the violations, so if folks carry out all the commitments which we have heard about here today, we are going to take a major step towards stopping terrorists, drug traffickers, and other wrongdoers from misusing and abusing the U.S. financial system for their nefarious purposes.

I want to again thank my colleague and my friend, Senator Coburn, and our staffs for the way they worked together and put together an extremely powerful report and for helping us to understand a very complex area.

We want to thank you, Mr. Curry, because you have taken over a very difficult job. You have done it with gusto. You have brought in a real sense of newness and a freshness, a determination to clean up that situation at OCC.

And with that, I will turn to Senator Coburn to see if he has any comments.

Senator COBURN. I just want to thank you all for your cooperation with us for your straightforwardness. What you have in front of you is not easy. Nobody ever said it was easy, but it is really important. So I take you, Mr. Curry, at your word that you are going to continue to communicate with this Subcommittee because decisive action and follow through—it is not enough to have a plan to fix this, you have to have a plan that gets executed and then monitored, and my hope is that we see a vigorous OCC that is the right amount, does not overreact but it is the right amount to do what we can do to stop some of the things that are going on that really only benefit those of criminal intent. So I thank you for your testimony and your time and your patience.

Thank you, Mr. Chairman.

Senator LEVIN. Thank you all. The record will be kept open for questions of this panel and all of our other panels and we will stand adjourned.

[Whereupon, at 4:49 p.m., the Subcommittee was adjourned.]

# APPENDIX

## PRESS RELEASE

U. S. Senate Permanent Subcommittee on Investigations  
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS COMMITTEE

Carl Levin, Chairman  
Tom Coburn, Ranking Minority Member



## FOR IMMEDIATE RELEASE

July 17, 2012

Contact: Tara Andringa 202-228-3685

### OPENING STATEMENT OF SEN. CARL LEVIN:

#### **“U.S. Vulnerabilities to Money Laundering, Drugs and Terrorist Financing: HSBC Case History”**

Today’s hearing will examine the money laundering, drug trafficking, and terrorist financing risks created in the United States when a global bank uses its U.S. affiliate to provide U.S. dollars and access to the U.S. financial system to a network of high risk affiliates, high risk correspondent banks, and high risk clients.

Most international banks have a U.S. affiliate. They use it in part to compete for U.S. clients and business, but also to provide themselves with access to the U.S. financial system. Global banks want access to U.S. dollars, because they are accepted internationally, are the leading trade currency, and hold their value better than any other currency. They want access to U.S. wire transfer systems, because they move money across international lines quickly, securely, and to the farthest corners of the earth. They want to clear U.S. dollar monetary instruments like travelers cheques, bank cheques, and money orders. And they want the safety, efficiency, and reliability that are the hallmarks of U.S. banking.

The problem here is that some international banks abuse their U.S. access. Some allow affiliates operating in countries with severe money laundering, drug trafficking, or terrorist financing threats to open up U.S. dollar accounts without establishing safeguards at their U.S. affiliate. Some operate in secrecy jurisdictions. Some allow poorly managed or corrupt foreign banks to make use of an affiliate’s U.S. dollar account. Others allow high risk clients to use those accounts without taking adequate anti-money laundering steps. Some even allow their affiliates to pressure their U.S. cousin to ease up on U.S. anti-money laundering restrictions or look the other way when they spot suspicious activity. The end result is that the U.S. affiliate can become a sinkhole of risk for an entire network of bank affiliates and their clients around the world playing fast and loose with U.S. banking rules.

The consequences are the ones you would expect from operating a U.S. bank with inadequate safeguards against money laundering. The U.S. bank can end up aiding and abetting transactions that fund terrorists, drug cartels, corrupt dictators, and tax cheats. Because all of them want access to the U.S. financial system, too, and for the same reasons. Wrongdoers can use U.S. dollars and U.S. wire transfers to commit crimes, arm terror groups, produce and transport illegal drugs, loot government coffers, even pursue weapons of mass destruction. That’s why our country has made combating money laundering and terrorist financing a national security imperative.

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For the last decade, this Subcommittee has contributed to the battle against money laundering and terrorist financing by exposing problems that increase U.S. vulnerabilities to abuse. In 2001, for example, this Subcommittee released a report showing how U.S. banks that offer accounts to foreign banks, engaging in what is known as correspondent banking, can become conduits for illicit proceeds involving organized crime, drug trafficking, or financial fraud. Back then, most U.S. banks opened a correspondent account for any foreign bank with a banking license. After our hearing, U.S. banks took a harder look and assessed the risks before opening a correspondent account. In 2002, Congress cited our hearings when enacting tougher anti-money laundering or AML laws in the Patriot Act, including a provision making it a legal obligation for U.S. banks to conduct a due diligence review before opening an account for a foreign bank.

Tougher AML laws have helped deny criminals access to the U.S. financial system. But as the report we're releasing today shows, enormous problems remain.

To illustrate those problems, today's hearing focuses on a case study involving HSBC, one of the largest banks in the world. Headquartered in London, HSBC has a network of over 7,200 offices in more than 80 countries, 300,000 employees, and 2011 profits of nearly \$22 billion. HSBC has been among the most active banks in Asia, the Middle East, and Africa. It first acquired a U.S. presence in the 1980s; today its leading U.S. affiliate is HSBC Bank USA, known as HBUS. HBUS has more than 470 branches across the United States and 4 million customers.

HBUS is the key U.S. nexus for the entire HSBC worldwide network. In 2008, it processed 600,000 wire transfers per week; in 2009, two-thirds of the U.S. dollar payments HBUS processed came from HSBC affiliates in other countries. One HSBC executive told us that a major reason why HSBC opened its U.S. bank was to provide its overseas clients with a gateway into the U.S. financial system.

Add on top of that, HBUS' history of weak anti-money laundering controls, and you have a recipe for trouble. In 2003, the Federal Reserve and New York State Banking Department took a formal enforcement action requiring HBUS to revamp its AML program. HBUS, which was then converting to a nationally chartered bank under the supervision of the Office of the Comptroller of the Currency, or OCC, made changes, but even before the OCC lifted the order in 2006, the bank's AML program began deteriorating. In September 2010, the OCC issued a Supervisory Letter, 31-pages long, describing a long list of severe AML deficiencies, and followed in October 2010, with a Cease and Desist order requiring HBUS to revamp its AML program a second time.

The OCC cited, among other problems, a massive backlog of unreviewed alerts identifying potentially suspicious activity; a failure to monitor \$60 trillion in wire transfers and account activity; a failure to examine risks at HSBC's overseas affiliates before providing them correspondent banking services; and a failure, over a three-year period, to conduct anti-money laundering checks on more than \$15 billion in bulk-cash transactions with those same affiliates.

To examine the issues, the Subcommittee issued subpoenas, reviewed more than 1.4 million documents, and conducted extensive interviews with HSBC officials from around the world, as well as officials at other banks, and with federal regulators. HSBC has cooperated fully with the investigation.

The Subcommittee's work identified five key areas of vulnerability exposed by the HSBC case history. The five areas involve:

- Providing U.S. correspondent accounts to high risk HSBC affiliates without performing due diligence, including a Mexican affiliate with unreliable AML controls;
- Failing to stop deceptive conduct by HSBC affiliates to circumvent a screening device designed to block transactions by terrorists, drug kingpins and rogue nations like Iran;
- Providing bank accounts to overcas banks with links to terrorist financing;
- Clearing hundreds of millions of dollars in bulk U.S. dollar travelers cheques, despite suspicious circumstances; and
- Offering bearer-share accounts, a high risk account that invites wrongdoing by facilitating hidden corporate ownership.

Let's take each in turn.

**High Risk Affiliate.** First is the issue of high risk affiliates. HSBC operates affiliates in 80 countries, including jurisdictions facing major money laundering, drug trafficking, or terrorist financing challenges as well as weak AML laws and oversight. Yet, until recently, HSBC's London-based parent company, known as HSBC Group, instructed its affiliates to assume that every HSBC affiliate met the group's AML standards and automatically provide it with correspondent banking services. HBUS did as told and opened U.S. correspondent accounts for more than 80 HSBC affiliates, ignoring the U.S. law requiring due diligence reviews before opening U.S. accounts for foreign banks.

HBUS' dealings with an HSBC affiliate in Mexico illustrate the money laundering dangers. HSBC Mexico or "HBMX" operates in a high risk country battling drug cartels; it has had high-risk clients such as casas de cambios; and it has offered high risk products such as U.S. dollar accounts in the Cayman Islands, a jurisdiction known for secrecy and money laundering. HBMX also has a long history of severe AML deficiencies. Add all that up and the U.S. bank should have treated HBMX, the Mexican affiliate, as a high risk account for AML purposes. But it didn't.

Instead, HBUS treated HBMX as such a low risk client bank that it didn't even monitor their account activity for suspicious transactions. In addition, for three years from mid-2006 to mid-2009, HBUS conducted no monitoring of a banknotes account used by HBMX to physically deposit billions of U.S. dollars from clients, even though large cash transactions are inherently risky and Mexican drug cartels launder U.S. dollars from illegal drug sales. Because our tough AML laws in the United States have made it hard for drug cartels to find a U.S. bank willing to accept huge unexplained deposits of cash, they now smuggle U.S. dollars across the border into Mexico and look for a Mexican bank or casa de cambio willing to take the cash. Some of those casas de cambios had accounts at HBMX. HBMX, in turn, took all the physical dollars it got and transported them by armored car or aircraft back across the border to HBUS for deposit into its U.S. banknotes account, completing the laundering cycle.

Over two years, from 2007 to 2008, HBMX shipped \$7 billion in physical U.S. dollars to HBUS. That was more than any other Mexican bank, even one twice HBMX's size. When law enforcement and bank regulators in Mexico and the United States got wind of the banknotes transactions, they warned HBMX and HBUS that such large dollar volumes were red flags for drug proceeds moving through the HSBC network. In 2008, after warnings from regulators, HBMX stopped taking large deposits of U.S. dollars, but for years, HBUS provided an easy gateway into our financial system for suspicious cash from a foreign affiliate.

**Circumventing OFAC.** A second problem involves actions taken by some HSBC affiliates to circumvent a U.S. ban on bank transactions involving designated drug traffickers, terrorists, or rogue regimes such as Iran. To enforce that ban, the U.S. Treasury Department's Office of Foreign Assets Control, or OFAC, has developed a list of prohibited persons which banks use to develop what's known as an "OFAC filter" to identify and stop prohibited transactions.

The Subcommittee found that, for years, HSBC affiliates in Europe and the Middle East acted to circumvent the OFAC filter when sending U.S. dollar transactions involving Iran through their accounts at HBUS. Although they viewed these Iranian transactions as legal under a U.S. exception for so-called "U-turn" transactions, the affiliates didn't want to trigger the OFAC filter and undergo the individualized reviews required to make sure. So they stripped out or omitted any reference to Iran from the paperwork. An outside auditor hired by HBUS has found that, from 2001 to 2007, HSBC affiliates sent nearly 25,000 transactions involving Iran, worth \$19.4 billion, through HBUS and other U.S. accounts, while concealing any link to Iran in 85% of the transactions.

HSBC's Chief Compliance Officer and other senior executives in London knew what was going on, but allowed the deceptive conduct to continue. While some HBUS officials in the United States claim not to have known they were processing undisclosed Iranian transactions, documents show key HBUS officials were informed early on. HBUS compliance and payments executives repeatedly told HSBC affiliates they had to use fully transparent Iranian transactions, but when faced with evidence that the affiliates were secretly circumventing the OFAC filter, no one in HBUS confronted those affiliates, brought the issue to a head, and forced the transactions to the light. Problems also arose when some HSBC affiliates tried to circumvent the OFAC filter to send potentially prohibited transactions involving other countries like Sudan or North Korea.

OFAC programs are aimed at exposing and disabling the financial dealings of some of the most dangerous persons and regimes in the world today, including terrorists, persons involved with weapons of mass destruction, drug traffickers, and rogue jurisdictions. The OFAC filter is the key to blocking prohibited transactions from polluting the U.S. financial system. Global financial institutions have a special responsibility to respect OFAC prohibitions, but that's not what happened here. While HSBC affiliates may have been aiming simply at avoiding processing delays, circumventing OFAC safeguards can also facilitate transactions undertaken by some of the world's worst wrongdoers.

**Disregarding Links to Terrorist Financing.** A third issue involves the fact that HSBC is active in regions of the world with significant terrorism challenges, while demonstrating a worrisome willingness to do business with banks that have links to terrorist financing. One example involves Al Rajhi Bank, the largest private bank in Saudi Arabia. After the 9/11 terrorist attack on the United States, evidence emerged that the bank's key founder was an early financial benefactor of al Qaeda and that it provided accounts to suspect clients.



In 2005, HSBC Group told its affiliates to sever ties with the bank, while making an exception for HSBC Middle East. Four months later, without explaining why, HSBC Group reversed itself and said all of its affiliates could decide whether to do business with Al Rajhi Bank. HBUS chose to close its Al Rajhi accounts. Over the next two years, however, its own bankers and bankers from other HSBC affiliates pressed HBUS to resume ties with Al Rajhi Bank. In 2006, after Al Rajhi Bank threatened to pull all of its business from HSBC unless HBUS reinstated its U.S. dollar banknotes account, HSBC gave in. Over the next four years, HBUS supplied Al Rajhi Bank with nearly \$1 billion in U.S. dollars, stopping only when HSBC made a global decision to exit the banknotes business altogether.

**Clearing Suspicious Bulk Travelers Cheques.** The fourth area of concern involves HBUS's willingness to clear suspicious bulk travelers cheques for foreign banks. From 2005 to 2008, on a regular basis, HBUS cleared \$500,000 or more per day in bulk travelers cheques for Hokuriku Bank of Japan. Routinely, these cheques arrived in large stacks of sequentially numbered cheques signed and countersigned with the same illegible signature. Forced by the OCC to investigate, HBUS found the Japanese bank could not provide any "know your client" information or explanation why two dozen of its customers, supposedly in the used car business, were often depositing \$500,000 a day in U.S. dollar travelers cheques purchased from the same bank in Russia. Under OCC pressure, HBUS stopped clearing the travelers cheques in 2008, but kept open the correspondent account, despite the Japanese bank's poor AML controls. In less than four years, HBUS provided over \$290 million in U.S. dollars to a Japanese bank for the benefit of Russians supposedly in the used car business.

**Offering Bearer Share Accounts.** Finally, there is HBUS's willingness to offer accounts to bearer share corporations. These corporations are prime vehicles for money laundering and other illicit activity by providing anonymity through assigning legal ownership of the corporation to whomever has physical possession of its shares. Over a decade, HBUS opened accounts for 2,000 such corporations, despite warnings by internal auditors and outside regulators that the accounts posed high money-laundering risks. Documents show the actual account owners deliberately pressured the bank to help hide their identities. One such account was used by a father-son team of Miami Beach hotel developers who were later convicted of tax fraud for hiding \$150 million in assets.

Bearer share accounts, suspicious travelers checks, banks with terrorist financing links, hidden transactions dodging OFAC safeguards, and Mexican drug money – none of them represent the types of transactions we want in a U.S. bank. If the parent corporation of a global bank can't do a better job policing its affiliates, we shouldn't be providing a bank charter to their U.S. affiliate. If the U.S. affiliate can't do a better job of standing up to affiliate pressures and safeguarding the U.S. financial system, federal regulators should consider whether to pull its charter.

HSBC Group recently issued a policy statement declaring that all of its affiliates would be subject to the highest AML standards among them; that its affiliates would start sharing information to strengthen their AML defenses; and that all affiliates would be subject to diligence reviews. HBUS has more than doubled the size of its AML compliance department, put in a new AML monitoring system, and closed over 395 high risk correspondent accounts. All good steps, but we saw this movie before in 2003. The recent commitments are surely welcome. Apologies and promises to improve are also welcome. But accountability for past conduct is essential, and that's what's been missing here.

**Exercising Ineffective AML Oversight.** It is bad enough that a single bank such as HSBC exposes the U.S. financial system to multiple money laundering risks. It is made worse when there is a failure of AML oversight by the OCC which is supposed to oversee our biggest banks. It is of great concern to the Subcommittee, and should be of great concern to every American, that the OCC tolerated the mounting AML problems at HBUS for five years, without taking any formal or informal enforcement action. In addition, when the OCC decided the problems had gone far enough, it lowered HBUS' consumer compliance rating instead of its safety and soundness rating. Every other federal banking agency treats AML deficiencies as a matter of safety and soundness; only the OCC treats AML deficiencies as if they were a matter of consumer protection law. AML safeguards aren't aimed at protecting bank customers, but rather the entire American public from wrongdoers seeking to misuse the U.S. financial system.

The OCC's new leadership needs to move swiftly to correct the previous oversight shortfalls and assure that promised changes at HSBC are implemented promptly and effectively.

Our report contains ten recommendations to address the abuses we've identified. Among the most important:

- HBUS should identify which of its sister affiliates are high risk, subject them to enhanced monitoring, and in particular review whether it should close the account of HSBC's Mexican affiliate.
- HBUS should beef up its OFAC compliance program by auditing affiliate transactions to see if they are circumventing the safeguards that protect our country and other countries from terrorists, drug traffickers, and rogue jurisdictions.
- HBUS should close accounts with banks suspected of involvement in terrorist financing, revamp its travelers cheque controls, and eliminate bearer share accounts.
- HSBC should require affiliates to share information to strengthen their AML defenses, and continue to beef up its compliance program which was given short shrift in the past.
- At the OCC, the agency should follow the lead of other regulators and treat AML compliance as a matter of safety and soundness.
- The new OCC leadership needs to get the OCC moving against money laundering by citing statutory violations, not just identifying failures as Matters Requiring Attention, in the face of AML deficiencies.

Global banks have caused the world a lot of heartache. Our focus today is one global bank that failed to comply with rules aimed at combating terrorism, drug trafficking, and the money laundering that fuels so much of what threatens the global community. I want to thank my staff for their extraordinary work, Ranking Republican Senator Coburn for all his support and the work of his staff, and turn to him now for his opening statement.

## Opening Statement of Senator Tom Coburn

Hearing of the  
U.S. Senate Permanent Subcommittee on Investigations  
“U.S. Vulnerabilities to Money Laundering, Drugs, and Terrorist Financing:  
HSBC Case History”  
July 17, 2012

I would like to thank Chairman Levin for holding this important hearing and for his tireless work to raise the issue of safety and soundness within the banking industry.

I would also like to thank both the Office of the Comptroller of the Currency and HSBC Bank for their full cooperation in this investigation. The OCC provided a number of people for interviews as well as essential documents about the regulatory process. HSBC Bank officials likewise sat for dozens of interviews and handed over millions of pages in documents. Some of today’s witnesses were flown in from posts around the world.

As Chairman Levin laid out in his statement, the Subcommittee’s investigation into anti-money laundering and anti-terror finance efforts at HSBC has covered quite a bit of ground. PSI examined in detail the types of vulnerabilities our nation faces from criminals and terrorists who want to take advantage and abuse our banking system and take away our freedoms. What we learned is that the United States faces unique risks, both because of our post-9/11 security needs and because of the strength of our financial system, which attracts worldwide attention.

Every day, countless transactions denominated in U.S. dollars occur around the world. This is good for our economy, which benefits from a strengthened currency and increased economic activity. But, criminals around the globe are also drawn to U.S. banks, which offer the attractive option of making their illicit funds look legitimate. If they can pass criminal proceeds through a U.S. bank unnoticed and untouched, the funds are unlikely ever to be stopped or recovered.

This hearing raises big and important questions. Banks want to obey the law, but also grow their businesses – what happens when the two conflict? Banks want to know their customers, but some customers want privacy – how do we resolve this? As we write AML policy, we should look for ways to get all boats rowing in the same direction, letting banks and government each do what they do best as we all work to combat crime and terror.

At HSBC, we uncovered a number of troubling examples in which weak AML systems may have let criminal or terrorist funds pass through. In Mexico, for example, billions of U.S. dollars flowed from the HSBC affiliate in Mexico. The Mexico affiliate was the single largest exporter of U.S. dollars in Mexico to HBUS. U.S. Law enforcement and the

regulatory entities have concluded that because of the volume of money, it likely came from proceeds of the illegal drug trade.

In another case, an Iranian bank was allowed to initiate U.S. dollar transactions that HSBC would process through the U.S. without explaining where they came from. At the time, however, there were severe legal restrictions on any payments come from or going to Iran, most often meaning they would be manually inspected. HSBC's affiliate in London coached the Iranian bank how to get the payments through the U.S. without inspection, and simply requested the bank send transactions that would not violate U.S. law. In effect, it relied exclusively on an Iranian bank to comply with a law intended to catch payments from Iranian banks. The bank or the officials that made that decision were either naïve or willfully blind.

This is why tough anti-money laundering laws are important, if illicit funds can be tracked and stopped, there are fewer places for criminals and terrorists to hide. And while our focus has been on the problems we found at HSBC Bank, we also have to emphasize that similar problems exist at other banks. For example, Citibank, Bank of America, Wachovia, Western Union and others have come under scrutiny for laundering drug cartels profits

The purpose of this hearing, then, is not just to make an example of HSBC, as if it were an anomaly. Rather, this hearing is to help Congress understand just what kind of risks this nation faces, and what we should do to reduce them. If we can get a better handle on the risks by looking closely at the operations of a single bank, we can write better laws and achieve our true goals: stopping crime and preventing terror.

With that in mind, I believe there are several lessons we can learn from the problems we uncovered at HSBC Bank.

First, banks around the world operate under different laws, creating different sensitivities to money laundering. While this seems apparent, it was not clear how much this would affect a bank with worldwide affiliates until we took a closer look. In the case of HSBC, its bank in the U.S. operated differently even than its own affiliates in London, Mexico and Middle East. Failure to recognize this can lull us into thinking we can rely on foreign banks to carry out U.S. law.

Second, bank regulators are sometimes better at identifying money laundering vulnerabilities than knowing how to fix them. Throughout this inquiry, it became clear the Office of the Comptroller of the Currency (OCC) was aware of many of HSBC's AML weaknesses, which it frequently pointed out. It was often at a loss, however, to prescribe how HSBC could eliminate the weaknesses. And so its record of enforcement at HSBC resembles a lapdog rather a watchdog that we sorely need.

We have also learned recently that investigators from Treasury's own Office of Inspector General have cited OCC personnel for unethical practices. The IG found an OCC examiner-in-charge accepted gifts, meals and even golf fees from executives at banks he was actively overseeing. This unfortunately was not an isolated incident, but other OCC employees were involved in other ethical violations. Taken together with our Subcommittee's findings in this investigation, these conflicts are startling and suggest Congress should give closer scrutiny to the OCC's actions.

That purpose here is to stop criminals from hiding their illicit funds and preventing terrorists from having the freedom to plot and plan. The metrics we use to measure a bank's AML compliance need to focus less on form and more on substance – how well are we achieving this goal?

This committee has shown the kinds of vulnerabilities we face. Too often what we found left us troubled, both for the risks to our nation and for the level of effort we saw to eliminate them. HSBC made its share of mistakes, and for which it is now being held accountable.

But we must all remember that money laundering always begins with a crime, and this ultimately is what we mean to fight. To the extent that this hearing results in criminals and terrorists having fewer options to rob and harm the American public, we will count it a success.

It may be impossible to stop all money laundering. Most of what we call money laundering in a certain context is a benign transaction in another. Buying travelers checks is innocent behavior for the tourist, but suspicious behavior when they are purchased in bulk by terrorists or drug lords. This does not mean we should not try to stop criminals from laundering their money through U.S. banks, but rather we need to do so wisely.

I appreciate the efforts made at HSBC to improve their AML systems, and sincerely hope that they stick. I look forward to hearing from their witnesses, as well as those from the OCC, and appreciate their appearance before us today.

**TESTIMONY OF DAVID S. COHEN**  
**UNDERSECRETARY FOR TERRORISM AND FINANCIAL INTELLIGENCE**  
**UNITED STATES DEPARTMENT OF THE TREASURY**  
**BEFORE THE**  
**PERMANENT SUBCOMMITTEE ON INVESTIGATIONS**  
**OF THE**  
**SENATE COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS**  
**U.S. VULNERABILITIES TO MONEY LAUNDERING, DRUGS, AND TERRORIST FINANCING: HSBC**  
**CASE HISTORY**  
**JULY 17, 2012**

**I. Introduction**

Chairman Levin, Ranking Member Coburn, distinguished members of the Subcommittee, thank you for inviting me to testify today. I am pleased to have the opportunity to discuss the importance of the Department of the Treasury's efforts to identify and combat money laundering and terrorist financing vulnerabilities in the U.S. banking sector. I would also like to commend this Subcommittee for the leadership it has demonstrated historically and again today by focusing much-needed attention on these critically important issues.

At the outset, it is important to recognize that the United States maintains one of the strongest and most effective anti-money laundering and counter-terrorist financing (AML/CFT) regimes in the world. But the scale, efficiency and sophistication of the United States' financial system—particularly its banking sector—make it a prime target for those who seek to conceal and move illicit money. This involves not just money launderers, of course, but terrorists, proliferators, drug lords and organized crime figures, who must, at some point, rely on the financial system to move or launder the illicit funds supporting or derived from their operations.

Recent enforcement actions against financial institutions in the United States are a powerful reminder to us that challenges remain. To meet these challenges, we closely monitor evolving threats and work to adapt and strengthen our anti-money laundering and counter-terrorist financing and sanctions policies, regulations and authorities. This work is a key component of our government's national security efforts—it serves to protect the integrity of our financial system from abuse by terrorists, drug traffickers and other illicit actors and gives us tools to impede and halt their dangerous activities.

Several primary authorities and activities drive the Treasury Department's work to combat money laundering and terrorist financing. They include our role through the Financial Crimes

Enforcement Network (FinCEN) as administrator of the Bank Secrecy Act (BSA), which enables us to impose special regulatory measures and requirements to combat money laundering and terrorist financing on a broad array of financial institutions. They also include authorities delegated to us by Executive Orders issued pursuant to the International Emergency Economic Powers Act (IEEPA) to impose financial and economic sanctions, based on all-source intelligence, to disrupt and dismantle illicit financial networks, such as those that support weapons of mass destruction, proliferation, drug traffickers, transnational organized criminal groups and terrorists. Given the maturity, scope and depth of the anti-money laundering and counter-terrorist financing regime today, Treasury works closely with its interagency partners in the regulatory, law enforcement, and national security communities, as well as the private sector, to combat the various illicit financing threats we face. Furthermore, given the increasingly global nature of the financial system, our efforts to strengthen our own anti-money laundering and counter-terrorist financing regime rely on cooperation and collaboration with international counterparts.

## **II. Nature and Scope of the Threat**

Financial crime and associated money laundering activity are difficult to measure with great precision. But by any estimate, the total amount of illicit money moved through and concealed within the U.S. financial system is massive—in the hundreds of billions—even if it represents only a small percentage of the funds in the financial system.

The sheer volume of money moving through the banking system makes banks the primary and most important line of defense against money laundering and terrorist financing. Therefore, our regulatory framework was built to require banks and other financial institutions to take a number of precautions against financial crime, including the establishment of AML programs and reporting and record keeping requirements to provide useful information to law enforcement and national security authorities for the purpose of combating the full range of illicit finance. This includes screening clients and transactions against Treasury's Specially Designated Nationals (SDN) List—a list of drug traffickers, proliferators, terrorists and other illicit actors or entities—to help ensure that funds associated with these actors do not enter the financial system. This regulatory framework aids banks in identifying and managing risk, provides valuable information to law enforcement, and creates the foundation of financial transparency required to apply targeted financial measures against the various national security threats that seek to operate within the financial system.

However when these safeguards are not stringently enforced, money launderers, terrorist financiers and other illicit actors are able to take advantage of the U.S. financial system. Some recent civil enforcement actions by FinCEN and the federal banking regulators illustrate how this can occur:

- In one case, failure to effectively monitor foreign correspondent banking relationships with high-risk customers and file suspicious activity reports (SARs) resulted in the processing of \$420 billion in cross-border financial transactions with thirteen high-risk

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Mexican *casas de cambio* from 2004-2007, through wire transfers, bulk cash and pouch and remote deposits, including millions of dollars subsequently used to purchase airplanes for narcotics traffickers.

- In several cases, foreign banks “stripped” out the names of Iran or other sanctioned entities in transactions routed through the United States, resulting in billions of dollars of benefits to sanctioned parties. A Swiss bank developed elaborate procedures to alter payments and used code names to disguise identities of sanctioned entities. A Dutch bank used misleading payment messages, shell companies and even advised sanctioned clients on how to conceal their involvement in U.S. dollar transactions.
- One bank’s failure to have a written AML policy and inadequate procedures to ensure the timely reporting of suspicious activity resulted in the processing of billions of dollars through accounts controlled by thirteen Mexican *casas de cambio* in just one year without filing suspicious activity reports.
- Inadequate AML staffing and procedures at another bank resulted in deficient monitoring and subsequent processing of large volumes of traveler’s checks and third party checks indicative of money laundering, including through sequentially numbered instruments.

On account of these and other substantial vulnerabilities in anti-money laundering and counter-terrorist financing and sanctions compliance, the United States government has instituted criminal fines and forfeitures totaling more than \$4.6 billion in approximately 20 BSA and IEEPA criminal prosecutions of financial institutions over the past 6 years.

These civil and criminal enforcement actions reveal not only how illicit financiers abuse our banking system, but also how compliance with our anti-money laundering and counter-terrorist financing and sanctions requirements is critical to protecting our financial system from such abuse.

### **III. Improving Our AML/CFT Regime**

These cases also point to significant vulnerabilities in the framework and enforcement of anti-money laundering and counter-terrorist financing requirements that require immediate attention. Trecasury is working together with its interagency partners and the private sector to better understand the anti-money laundering and counter-terrorist financing and compliance challenges faced by financial institutions, clarify U.S. government expectations of financial institutions, and strengthen the overall anti-money laundering and counter-terrorist financing regulatory regime. I will briefly outline just a few of our efforts.

#### *Ongoing Targeting of Illicit Actors*

One of the most important activities for which my office is responsible is the listing of illicit actors on OFAC’s SDN list. As banks and financial institutions screen their business dealings



against the sanctioned entities on this list, they are able to prevent the entrance of terrorist funds, drug-trafficking proceeds or other illicit money into our formal financial system, or freeze transactions by designees where they occur. All major global banks, and many smaller foreign ones, screen transactions against the OFAC list to protect themselves, even though they are not required to do so. This markedly amplifies the impact of our sanctions by preventing the movement of illicit funds by terrorists, organized crime figures or proliferation networks outside of U.S. jurisdiction. We watch closely for illicit actors evading anti-money laundering and counter-terrorist financing controls at banks in the U.S. and abroad and for their attempts to seek “back door” entry into the financial system, including through the various evasive tactics evident in the cases described above.

*Customer Due Diligence Advance Notice of Proposed Rulemaking*

Customer due diligence, and the financial transparency it facilitates, is central to our efforts to combat all manner of illicit financial activity, from proliferation and terrorist financing to more traditional forms of financial crime like money laundering and securities fraud. Treasury issued an Advance Notice of Proposed Rulemaking (ANPRM) on March 4 to clarify, consolidate and strengthen customer due diligence requirements for financial institutions, including an obligation to collect beneficial ownership information. This rulemaking will improve financial institutions’ ability to detect suspicious activity and provide more useful information to law enforcement. The comment period for the ANPRM closed on June 11 and Treasury will hold the first in a series of public hearings to collect additional comments on July 31. Our engagement with industry in the customer due diligence rulemaking process is facilitating a broad understanding of higher risk type accounts and transactions with respect to money laundering and terrorist financing, and how we can work with industry and our interagency partners to better identify and manage such risks, including through more effective anti-money laundering and counter-terrorist financing safeguards.

*Enhancing Transparency in the Company Formation Process*

Criminals can easily disguise their ownership and control of illicit proceeds through shell companies and other seemingly impenetrable legal structures. We are working closely with you, Mr. Chairman, and other members of Congress to enact legislation requiring disclosure of beneficial ownership information in the company formation process.

*Promoting and Strengthening the Global AML/CFT Framework*

Helping to strengthen anti-money laundering and counter-terrorist financing regimes abroad has a direct benefit to the safety and integrity of the U.S. financial system, given the global nature of money laundering and the terrorist financing threat and the relationships between banks abroad. The Office of Terrorism and Financial Intelligence (TFI) works with others in the U.S. government to strengthen the global anti-money laundering and counter-terrorist financing framework as a foundation for the effective implementation of sound financial controls worldwide. Several intergovernmental and international organizations, such as the Financial Action Task Force, the IMF, the World Bank, the United Nations, and various FATF-style

regional bodies, collectively develop, assess and facilitate jurisdictional implementation of measures that are essential to combating various forms of illicit finance. Treasury and its interagency partners play a key leadership and participatory role in these organizations as well as other organizations that support our capacity building objectives, lending technical expertise in standard-setting, evaluation and policy recommendations related to the combating of money laundering, terrorist and proliferation financing. One of the key substantive accomplishments that we have achieved in developing the global anti-money laundering and counter-terrorist financing framework is to integrate targeted financial sanctions against terrorist financing and proliferation finance into the global standards for combating money laundering. This is some of the most innovative work my office conducts and an area in which we are able to urge the international community forward in highly constructive ways.

#### **IV. Conclusion**

I began today's testimony by noting that the U.S. is home to one of the strongest anti-money laundering and counter-terrorist financing systems in the world. In order to continue in this role, we must push ourselves to identify where we can do better, and work tirelessly to get there. I look forward to continuing work with this committee to this end.

Thank you.



# U.S. Immigration and Customs Enforcement

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STATEMENT

OF

LEIGH H. WINCHELL

ASSISTANT DIRECTOR FOR PROGRAMS  
HOMELAND SECURITY INVESTIGATIONS

U.S. IMMIGRATION AND CUSTOMS ENFORCEMENT

REGARDING A HEARING ON

*"COMBATING MONEY LAUNDERING"*

BEFORE THE

UNITED STATES SENATE  
COMMITTEE ON HOMELAND SECURITY  
AND GOVERNMENTAL AFFAIRS  
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

TUESDAY, JULY 17, 2012 -- 9:30 a.m.  
106 DIRKSEN SENATE OFFICE BUILDING

**INTRODUCTION**

Chairman Levin, Ranking Member Coburn, and distinguished members of the Subcommittee:

On behalf of Secretary Napolitano and Director Morton, thank you for the opportunity to appear before you today to discuss the efforts of U.S. Immigration and Customs Enforcement (ICE) to combat transnational criminal organizations (TCO) and the illicit proceeds used to fund their criminal activities. With expansive investigative authority, ICE is well-positioned, in partnership with U.S. Customs and Border Protection (CBP), to disrupt and dismantle transnational criminal networks and terrorist organizations that seek to exploit our borders and America's legitimate trade, travel, communications, and financial systems.

ICE's expertise in combating TCOs that take advantage of vulnerabilities in the sea, air, and land environments has proven essential in countering the smuggling of narcotics, money, dangerous goods, people, and materials that threaten the well-being of the United States. Our law enforcement presence is global, and ICE's Homeland Security Investigations (HSI) has a wide network of agents in Attaché offices at embassies and consulates worldwide, all working in concert to target TCOs.

***Illicit Finance and Bulk Currency***

One of the most effective methods for dismantling TCOs is to attack the criminal proceeds that are the lifeblood of their operations. HSI takes a holistic approach toward investigating money laundering, illicit finance, and financial crimes by examining the ways that individuals and criminal organizations earn, move, store, and launder their illicit proceeds.

The combination of successful financial investigations, reporting requirements under the Bank Secrecy Act (BSA) of 1970, and anti-money laundering compliance efforts by financial institutions has no doubt strengthened banking systems and forced criminal organizations to seek other means to diversify the movement of illicit funds, such as the use of money service businesses (MSB), prepaid access devices, and bulk cash smuggling.

HSI's broad jurisdiction includes the enforcement and investigation of money laundering and bulk cash smuggling violations. In FY 2011, HSI special agents initiated more than 4,270 financial investigations, resulting in: more than 1,770 arrests; over 1,070 criminal indictments; more than 1,040 criminal convictions; and more than 7,700 seizures worth approximately \$359 million, including \$331 million in currency and monetary instruments.

#### *National Bulk Cash Smuggling Center*

On August 11, 2009, HSI officially launched the National Bulk Cash Smuggling Center (BCSC), in cooperation with the El Paso Intelligence Center, as a 24/7 investigative support and operations facility. The BCSC has undertaken a full assessment of the bulk cash smuggling threat and developed a strategic plan to address the problem. By analyzing the movement of bulk cash as a systematic process, HSI develops enforcement operations specifically designed to combat the various methodologies currently employed by trafficking organizations. This targeted approach allows us to more efficiently and effectively utilize our interdiction and investigative resources.

Since its inception, the BCSC has initiated over 500 criminal investigations resulting in 132 seizures totaling \$65.8 million. These investigations have culminated in 319 criminal arrests, 96 indictments, and 68 convictions in both Federal and state courts. The

BCSC has also provided training and outreach to over 21,000 state, Federal, and international partners.

As an example of a recent success, in April 2012, the BCSC coordinated with HSI field offices in St. Louis, Missouri, and Greeley, Colorado, in support of a controlled delivery of illicit bulk cash proceeds of nearly \$265,000. The initial seizure was the result of a traffic stop, but agents developed additional information based on this initial seizure to successfully execute a second controlled delivery of the currency, which resulted in the seizure of an additional \$385,359 in U.S. currency, over seven kilograms of cocaine, two handguns, and five vehicles, and in seven arrests.

#### ***Operation Firewall***

HSI's Operation Firewall disrupts the movement and smuggling of bulk cash en route to the border, at the border, and internationally via commercial and private passenger vehicles, commercial airline shipments, airline passengers, and pedestrians. Since 2005, Operation Firewall has been enhanced to include surge operations targeting the movement of bulk cash destined for and crossing the U.S. borders with Mexico and Canada, and joint interdiction efforts and investigations with our foreign law enforcement counterparts.

Through May 31, 2012, Operation Firewall has resulted in more than 6,700 seizures totaling more than \$621 million, and arrests of over 1,400 individuals. These efforts include 480 international seizures totaling more than \$271 million and 310 international arrests.

***Cornerstone Outreach Initiative***

In July 2003, ICE launched its Cornerstone Outreach Initiative to work in partnership with the private sector to systematically and strategically identify and eliminate vulnerabilities in financial systems through which criminals launder their illicit proceeds. Under this initiative, HSI builds both domestic and international partnerships by sharing law enforcement trends and methods with businesses and industries that manage the systems that terrorists and criminal organizations seek to exploit.

To the extent permitted by law, HSI shares what we learn through our investigations with the private sector to assist them in identifying and preventing attempts by criminal organizations to take advantage of weaknesses in financial systems. HSI special agents serve as subject matter experts in various types of money laundering methods, including fraudulent schemes, money service businesses, casinos, non-cash negotiable instruments, alternate remitters, charities, outbound currency initiatives, organized retail crime, and schemes to pay illegal alien workers.

Through May 31, 2012, HSI special agents have conducted nearly 12,000 Cornerstone outreach and training presentations to 248,000 participants worldwide. Our outreach efforts have resulted in the initiation of 950 criminal investigations that led to 290 arrests, 270 indictments, 228 convictions, and the seizure of nearly \$668 million.

***Trade-Based Money Laundering (TBML)***

TBML is a money laundering method through which TCOs earn, move, and store illicit proceeds by disguising them as legitimate trade. TCOs often exploit global trade networks to move value around the world, using the complex and sometimes confusing documentation that is frequently associated with legitimate trade transactions. To illustrate, Colombian drug cartels

use TBML extensively to repatriate drug proceeds in a scheme commonly referred to as the Black Market Peso Exchange.

Money and value transfer systems not subject to regulation or supervision, in violation of the international standards, such as underground banks and unlicensed money service businesses, are utilized by TCOs to move value via trade as settlement of a debt arising from remittances overseas. These organizations can accomplish settlement by purchasing commodities in one country and then transferring them to another country where the commodity is sold and the proceeds remitted to the intended recipient.

HSI is uniquely positioned to disrupt and dismantle TCOs that seek to launder illicit proceeds through manipulation of international trade and financial systems. Through HSI's Trade Transparency Unit (TTU), ICE is the only U.S. law enforcement agency partnering with foreign nations to exchange trade data.

HSI currently has foreign TTU partnerships with Mexico, Panama, Brazil, Colombia, Ecuador, Argentina, Paraguay, and Guatemala. Through these partnerships, HSI is able to identify, investigate, and prosecute TCOs engaged in TBML and other forms of illicit finance. HSI's TTU, our special agents, and intelligence analysts in the field, along with foreign customs and law enforcement agencies responsible for border control and enforcement of financial crimes, utilize a HSI TTU-owned and developed computer system called the Data Analysis & Research for Trade Transparency System (DARTTS) to analyze trade and financial data.

DARTTS is capable of identifying international trade anomalies and financial irregularities indicative of TBML, customs fraud, contraband smuggling, and other crimes. For example, DARTTS allows users to quickly analyze large amounts of data in a short period of time, thereby maximizing limited time and resources. HSI field agents and analysts frequently



employ DARTTS' unique capability to conduct data research and analysis to initiate and or further criminal investigations. This analysis goes beyond conventional database queries and link analysis tools as part of HSI's efforts to combat and address the global threat posed by TBML.

TTU methodology has been highlighted in numerous U.S. Government publications including *The National Money Laundering Threat Assessment*, the U.S. Department of the Treasury's *National Money Laundering Strategies*, and the U.S. Department of State's *International Narcotics Control Strategy Reports*. It was also recognized as a "best practices approach" by the Financial Action Task Force, the international standard-setting body on countering money laundering and terrorist financing, originally established by the Group of Seven member states, the European Commission and eight other countries to examine and develop measures to combat money laundering and terrorists financing.

Other countries have shown increased interest in establishing and developing their own TTU. Many of the TTUs established, most recently in Colombia and Guatemala, have benefited from the funding and support of the State Department's Bureau of International Narcotics and Law Enforcement Affairs. Future funding to expand the TTU network is under consideration.

#### ***Other Evolving Methods Including Prepaid Cards and Stored-Value Devices***

The terms "prepaid card" and "stored value card" (collectively "prepaid access devices") are commonly used to refer to any card that represents money stored on or accessible by a card to facilitate a consumer's purchase of goods, services, or further conversion to cash through an ATM. These cards may be "open loop" or "closed loop." Open loop cards are usually network branded (such as Amex, Discover, MasterCard, or Visa), often reloadable, and can be used at

point of sale at terminals and ATMs anonymously. Closed loop cards, on the other hand, are designated for use at a specific merchant, typically have load limits, and cannot be converted back to cash. Examples of closed loop prepaid access devices include gift cards, mass transit cards, and prepaid phone cards.

According to the 2007 U.S. National Money Laundering Strategy, "stored value cards (sometimes referred to as prepaid cards) are an emerging cash alternative for both legitimate consumers and money launderers alike." Of the two types, money launderers appear to prefer the open loop prepaid access devices because of their capability of being used at point of sale terminals, their wide acceptance by hotels and car rental agencies, and their portability. These cards enable the user to obtain cash from ATMs worldwide without going through a currency exchange.

Additionally, cards issued by offshore financial institutions and, therefore, not subject to U.S. reporting requirements, are widely available on the Internet, including cards with very high load limits. Prepaid access devices may be attractive to money launderers and smugglers as an alternative to bulk cash not only because their small size and portability make them difficult to detect in the manner that we detect bulk cash, but also because they are not expressly defined as monetary instruments under U.S. statutes and regulations. Therefore, they are not yet expressly and specifically subject to the CMIR reporting requirements or the potential bulk cash smuggling and structuring violations that stem from this requirement.

The Credit Card Accountability, Responsibility, and Disclosure Act of 2009, signed into law in May 2009, mandated that the U.S. Department of the Treasury (Treasury), in consultation with DHS, address the risks associated with these cards. HSI has worked with our law enforcement partners and the Treasury Department's Financial Crimes Enforcement Network to

close vulnerabilities associated with prepaid devices. This resulted in the publication of a final rule that applies the Bank Secrecy Act to the domestic prepaid device industry and the publication of a Notice of Proposed Rulemaking that proposed to classify prepaid access devices as monetary instruments for the purposes of cross-border declaration. This proposed rule is currently being finalized as Treasury reviews and addresses the public comments. We look forward to the final publication of this rule in the near future.

One of the most significant developments in recent years was a change in Mexican banking regulations implemented in June 2010 that severely limits the amount of U.S. dollars that can be deposited within Mexican financial institutions. This change has ultimately proven to be a successful tool in combating drug trafficking and the TCOs that control the movement and smuggling of drugs by causing them to change how drug proceeds are laundered. We believe that as a result of this change, TCOs may seek to place these funds into U.S. financial institutions and then wire the proceeds back to Mexico. We continue to work closely with the Government of Mexico (GoM) to identify emerging money laundering trends.

Domestically, we have seen changes in how illicit proceeds are moved within the United States. In the last several years, we have seen domestic drug organizations attempt to place illicit funds into U.S. financial institutions to avoid currency transaction reporting requirements. In one version of this scheme, which is referred to as the “funnel account” model, drug organization members in destination cities make structured cash deposits into bank accounts opened in the United States. In turn, the account holder (a nominee for the drug organization) will withdraw funds at various banking institutions in the United States and turn them over (often minus a small fee) to the drug organization. The scheme has been difficult for bank anti-money laundering personnel to identify.

This tactic was initially identified in human smuggling organizations operating in Arizona, but we have since seen its use expanded to domestic drug organizations. We believe that the emergence of this tactic came as a direct result of the successful enforcement focus on MSBs that were being used by human smugglers to receive payments from “sponsors” in the United States. When the ability to easily use MSBs was disrupted, a transition to the funnel account model was observed. HSI has worked with other U.S. Government agencies, including FinCEN, to educate the financial industry in order to promote the identification of this scheme and reporting to law enforcement.

***Illicit Pathways Attack Strategy (IPAS)***

Last July, the Administration took an important step in fighting transnational crime when it issued its *Strategy to Combat Transnational Organized Crime* (TOC Strategy). This strategy complements the current *National Security Strategy*, and other national strategies and plans related to trafficking in persons, money laundering, and other transnational crime affecting the United States, by focusing on the growing threat of international criminal networks. The strategy's single unifying principle is to build, balance, and integrate the tools of American power to combat transnational organized crime, and related threats to national security—and to urge our international partners to do the same.

HSI designed the Illicit Pathways Attack Strategy (IPAS) to build, balance, and integrate its authorities and resources, both domestic and foreign, in a focused and comprehensive manner to target, disrupt, and dismantle TOC. As recognized in the TOC Strategy, resources are not limitless, and targets must be prioritized in a systematic manner. The IPAS will provide a

mechanism for ICE to prioritize threats and vulnerabilities within its mission and to coordinate its own efforts internally and within the interagency.

The IPAS goes beyond the Nation's physical borders. By targeting the profits generated and used by criminal organizations and not just targeting the contraband being smuggled, the IPAS will protect financial systems and strategic markets by addressing how criminal organizations earn, move and store illicit proceeds. IPAS will target financial institution abuse, bulk cash smuggling and trade-based money laundering and aggressively pursue asset forfeiture.

#### ***Working with Mexican Authorities***

Working with the GoM in its battle against the drug cartels and other TCOs requires strong coordination and cooperation. ICE continuously works jointly with the GoM to initiate and support investigations and operations targeting TCOs and their diverse list of illicit activities. ICE also actively participates in capacity-building programs and initiatives to strengthen and bolster the GoM counter-narcotics and counter-illicit finance efforts.

On June 2, 2010, DHS released the Department of State Bureau of International Narcotics and Law Enforcement-supported Bi-National Criminal Proceeds Study at a United States-Mexico Money Laundering Conference in Mexico City, which provided a strategic-level analysis of the processes and methods used by transnational criminals, particularly drug trafficking organizations, to repatriate illicit money from the United States to Mexico and other countries. Both the U.S. and Mexican Governments are using information collected from the study to conduct tactical operations that deny criminals the ability to move money, and to ultimately dismantle illicit operations.

ICE has strengthened its relationship with the GoM by increasing the number of HSI personnel in Mexico, who provide support to ongoing investigations of TCOs operating on both sides of the border. In addition, the HSI Attaché in Mexico City has created its own Transnational Criminal Investigative Unit consisting of fully vetted Mexican law enforcement officers. Through the HSI Attaché office in Mexico City and associated sub-offices, HSI personnel, in conjunction with the law enforcement community, will continue working closely with Mexican authorities.

#### **CONCLUSION**

Thank you again for the opportunity to appear before you today to discuss our efforts to combat the money laundering threat to the United States and our response to the innovative techniques being used by TCOs.

I would be pleased to answer any questions.

**David Bagley**  
**Head of Group Compliance**  
**HSBC Holdings plc**  
**Written Testimony for Senate Permanent Subcommittee on Investigations**  
**July 17, 2012**

Good morning Chairman Levin, Ranking Member Coburn, and members of the Subcommittee. My name is David Bagley. Thank you for the opportunity to be here today.

Since 2002, I have been the Head of Group Compliance at HSBC Holdings plc – which is the global parent of HSBC. I joined Midland Bank in 1992 and, later that year, after HSBC acquired Midland, I began work for HSBC in its Head Office in London, where I work today. Over the years, I have served in various positions in HSBC offices around the world.

Having been a compliance officer for 13 years in a bank that operates in approximately 80 jurisdictions worldwide, I have dedicated my career – not only within HSBC but through my broader industry work as well – to meeting the sometimes significant challenges that confront global banking institutions in the world we live in. As this Subcommittee well knows, these challenges include money laundering by narcotics traffickers and terrorist financing, to name just a few. I have followed the work of this Subcommittee and have seen how your work has advanced important dialogues and helped the international banking community, including HSBC, identify and address potential vulnerabilities.

My chief focus as the Head of Group Compliance at HSBC has been promoting the values that we as a bank have set for ourselves and the values that you and our regulators, both in the United States and around the world, rightly expect from a global bank like HSBC. And, while there have been successes on many compliance issues, I recognize that there have been some significant areas of failure. I have said before and I will say again: despite the best efforts and intentions of many dedicated professionals, HSBC has fallen short of our own expectations

and the expectations of our regulators. At the same time, this is something that a bank seeking to conduct business in the United States and globally must acknowledge, address, learn from, and, most importantly, take steps to avoid in the future.

I know my time today is limited and there are a number of topics to discuss. Let me touch on some of them briefly.

First, we have learned a number of valuable lessons, and the bank is well along the way of converting those lessons into solutions. One of these lessons concerns managing growth. With the benefit of hindsight, it is now clear to many of us that the bank's business and risk profile grew faster than its infrastructure. We have learned that implementing the kinds of robust policies and practices expected of a global banking leader can take longer than anticipated. The bank underestimated some of the challenges presented by its numerous acquisitions, and despite efforts to meet these challenges, we were not always able to keep up. While many people at HSBC worked diligently to get it right, the bank simply must do better.

How can we get it right? Let me touch briefly on a few of these changes.

As I expect my colleague Stuart Levey to describe in some detail, HSBC is in the process of shedding the historical compliance model that the bank has outgrown. This departure from the old model is transformative. Our former compliance structure was a product of historical growth by acquisition and it was a major factor behind some of the issues that I expect we will be discussing today.

Under the former structure, the bank's Group Compliance function based in London mirrored HSBC's overall global corporate structure – which is an international federation of affiliates around the globe. Many of these affiliates began as relatively small independent banks that HSBC acquired over the years with increasing frequency. As the bank's footprint grew



through these acquisitions, HSBC's structure evolved into one with a small corporate center, on the one hand, and numerous affiliates around the world operating with a significant degree of autonomy and varying levels of direct interaction among those affiliates, on the other.

Under the former model, the role of Group Compliance was an advisory one: we promulgated the baseline standards that all of the bank's affiliates were expected to follow. As the Head of Group Compliance, my mandate was limited to advising, recommending, and reporting. My job was not – and I did not have the authority, resources, support, or infrastructure – to ensure that all of these global affiliates followed the Group's compliance standards. Rather, final authority and decision-making rested with local line management in each of the bank's affiliates.

This model worked for many years. But over time, HSBC's growth accelerated rapidly. Some of the new acquisitions had operations that at the time of acquisition fell far short of HSBC's own compliance standards and expectations and were in relatively lightly regulated but often high risk jurisdictions. At the same time, increased terrorism and narco-trafficking, and other financial sector developments, exposed the international banking system to new vulnerabilities and greater challenges. In addition, regulatory expectations both in the United States and abroad rightly continued to increase. With its roots in a far smaller bank in a very different global banking environment, HSBC's historic model, in retrospect, simply did not keep pace. Now, a major overhaul is underway.

The new compliance model is a product of deep reflection and is tailored to address today's challenges as well as the inevitable challenges of tomorrow. Let me mention a few significant differences between the bank's prior compliance model and the new model.

First, the bank's Group Compliance function now, for the first time, has authority over the compliance departments at every one of the bank's affiliates. The new model empowers Group Compliance to adopt and implement consistent compliance standards across the Group and to assess each of the bank's affiliates through a dedicated Assurance team so that the Group can have confidence that its affiliates are following and enforcing these standards. This is a stark break from the past. Now, Group Compliance has both the mandate and the resources to ensure that affiliates are compliant. In other words, now for the first time, Group Compliance is an advisory and a control function and personnel at the affiliates are now accountable to Group Compliance for their conduct.

Second, the CEO of each affiliate previously controlled the allocation of resources and compensation associated with that affiliate's compliance function. That has changed as well. Under the new model, Group Compliance oversees the bank's nearly 3,500 compliance officers worldwide and takes the lead on decisions about resource allocation, compensation, performance review, objectives, strategy, budget, and accountability across all of our worldwide compliance departments. This gives Group Compliance far more control over and understanding of the bank's global compliance efforts.

Third, HSBC has made significant enhancements to the resources at the Group Compliance level. In 2002, when I took on the role of Head of Group Compliance, we had a staff of only eight people. Now we have close to 40 people working in Group Compliance in London, and that figure continues to grow.

Fourth, the bank has adopted new robust diligence policies. Historically, unless required by the local jurisdiction, the bank did not mandate that HSBC affiliates perform due diligence on other HSBC affiliates. However, we now require affiliates to perform diligence on each other.

And, we are in the process of rolling out the enhanced Know-Your-Customer program at our U.S. bank on a global scale. This is a substantial task because HSBC has approximately 100 million customer relationships worldwide. Nevertheless, it is an important one. It will enable the bank to make more informed and responsible decisions about its customers.

While I will not touch on all of the recent enhancements to our model, I do want to elaborate on one of these changes, the creation of a dedicated Assurance team. The mission of this new function is both to review the effectiveness of our compliance functions at all levels around the globe and to escalate compliance issues that need remediation. This team is charged with ensuring that our compliance efforts around the world meet Group standards, conducting proper monitoring, and meeting the expectations of their regulators. The team is also charged with ensuring that compliance issues are properly escalated to the Group level, that the business and compliance functions are working together to manage risk effectively and responsibly, and that every compliance team has the required skills and appropriate resources. This function, which is in addition to the continuing role of Group Audit in conducting audits of affiliates worldwide, has already provided substantial benefits.

In conclusion, the authority of the Head of Group Compliance and therefore the function as a whole is greatly increased. We have split from the legal function and now form a part of a substantially empowered risk function. This will require affiliates to act on advice and recommendations quickly and effectively.

\* \* \*

Despite the best intentions and efforts of so many dedicated compliance and business professionals, HSBC has in some important areas failed to meet our expectations and the expectations of our regulators. I am happy, however, to be able to say that the bank has learned from its past and is already on a path to becoming a better, stronger banking institution. The bank's structure is, in short, very different from what it was in 2002, when I agreed to serve as Head of Group Compliance.

Thank you for your time. I welcome this opportunity to answer any questions.

**Paul Thurston**  
**Chief Executive, Retail Banking and Wealth Management**  
**HSBC Holdings plc**  
**Written Testimony for Senate Permanent Subcommittee on Investigations**  
**July 17, 2012**

**I. Introduction**

Good morning Chairman Levin, Ranking Member Coburn, and members of the Subcommittee. My name is Paul Thurston, and I currently serve as the Chief Executive, Retail Banking and Wealth Management for HSBC Group, based in Hong Kong.

I have worked in the banking industry for my entire career. I joined Midland Bank in 1975, and stayed when it was acquired by HSBC in 1992. Since then, I have served in various roles at HSBC around the world, including as CEO of HSBC Mexico ("HBMX") for fourteen months beginning in February 2007.

I understand that we are here today in part to discuss HSBC's experience in Mexico and its impact on the U.S. and global financial systems. These are topics worthy of discussion, and which have had many learnings for our Group, and I am pleased to be here at the Committee's request. I want to address in my statement the challenges I faced when I arrived in Mexico, the steps my colleagues and I took to address the problems, and the lessons I believe we at HSBC have learned from our experience in Mexico.

**II. HBMX**

Emerging markets like Mexico are growing increasingly important in their contribution to the global economy and world trade, and international financial companies can play an important role to help their governments develop these markets and their people to join the formal banking system. With large populations existing outside the formal economy and banking system, however, they also present real challenges.

I arrived in Mexico in early 2007 after having served as a general manager with responsibility for building the Group's personal financial service businesses across the Asia Pacific region. When I arrived, I reported to my predecessor, who, having completed the acquisition of the former Banco Bital and managed this business for 4 years, had also led the subsequent acquisition of the Banistmo Group of banks across Central America and been promoted to head up the Latin American region.

To enable me to assess the business, I had meetings with members of the management team, the internal auditors, the external auditors, and the Board of HBMX. I also met with the regulators, each of whom were complimentary about the progress made by the bank since acquisition. It became clear to me, however, that there had been rapid growth of the business since the acquisition, and that there were still significant issues that needed to be addressed. These included rapidly growing credit and fraud losses in the consumer and small business lending businesses, technology problems, and weaknesses in management information. There was also a significant known compliance issue relating to the quality of customer Know-Your-Customer ("KYC") and customer files, all of which were decentralized across the network of more than 1300 branches, but where recent regulations required 1.8 million customer KYC records to be remediated to meet new local standards.

Having thought that I would be continuing to build the business, my immediate priorities became to address these issues. Additionally, most of the management team of the bank in Mexico had also been promoted to regional positions to manage the now larger region, and I therefore had to fill key positions within the Mexican business to ensure that we retained a focus on managing this business.

As I began to get the team in place, additional issues arose, and it became clearer that HBMX lacked much of the sophisticated compliance, operational, and risk management capabilities with which I was familiar from my work in other parts of the Group. There was no credit fraud expertise, credit risk analytics were undeveloped, and provisioning models and scorecards were not robust. It also became apparent that decision-making processes concerning AML were not satisfactory.

Over time, it also became clear that this was not only a question of process and technology, but that the underlying business model needed to be examined. Branch managers operated as local franchise owners, with considerable autonomy and a focus on business development, reinforced by an incentive compensation scheme which rewarded new accounts and growth, not quality controls.

I should add that the external environment in Mexico was as challenging as any I had ever experienced. Bank employees faced very real risks of being targeted for bribery, extortion, and kidnapping – in fact, multiple kidnappings occurred throughout my tenure – and high levels of security were required for Bank staff working in Mexico. Unlike the United States, Mexico was a data-poor environment, making it difficult to verify the identity of customers.

Despite these substantial challenges, I felt that with determined efforts, the Bank could make a positive contribution in Mexico. During my short tenure at HBMX, I worked hard to make progress towards this goal, and I drove many changes to both the business model and compliance systems.

I pulled back on business expansion plans and focused on enhancing controls. I was particularly concerned with HBMX's significant operational and credit losses, especially in small business loans and credit cards, where fraud was rising rapidly. I brought in people with

expertise in managing emerging markets credit risk in Asia and fraud management from the Group to review our practices in those areas, tightened credit approvals, and brought in a new Head of Consumer Credit Risk. I also brought in a new CFO to develop improved management information capabilities.

To address the compliance issues, I brought in a new COO who was well-regarded and experienced with Group standards. With his help, we made significant changes in AML and KYC processes, including addressing AML Committee weaknesses, ensuring that action items were properly followed up, and creating an escalation process when business and compliance disagreed. We launched new staff training programs on AML and KYC standards, and introduced a zero tolerance policy regarding the site visit requirement.

Recognizing the challenges of trying to affect proper remediation of files and upgrading account opening processes across a widespread branch network managed by local managers incentivized and historically managed for growth, we set up a program to centralize control of account opening documentation and KYC records. We also reworked the employee incentive scheme to reduce reward for volume growth and increase the focus on credit quality, customer service, and proper management of risk. We also removed senior management from the incentive scheme entirely.

As you might expect, these changes were painful to the organization. For example, to rework the incentive scheme, at one point I had to stop payment of incentives altogether. This resulted in employees picketing the office. However, my team and I were determined to continue pushing forward with the improvements.

All of the issues that I identified, and the actions taken to address them, were reported up to the regional head of Latin America and to Group management. I requested Group Compliance

support to help review issues and people, and address cross-border issues. I also requested Group Audit to undertake audits of key processes, including the Money Laundering controls, to have an independent check of progress and help to surface other issues that had not previously been identified. The local Board, and the regional audit committee, which was chaired by the Group's Chief Risk Officer and head of Audit, were kept informed throughout. Reports were made to the Group Risk Management Meeting which included the heads of each of the regions.

In December 2007, less than a year after I had arrived, I was asked by the Group Chief Executive to prepare to move to the U.K. to take responsibility for our retail business there in the face of issues that led up to global financial crisis and to recruit a successor in the local market. I did this and left Mexico in April 2008.

I believe that we made progress at HBMX during my short tenure, but clearly there was still much work to be done upon my departure. I understand that further problems surfaced subsequently, which had to be addressed by my successor and Group management, and that progress was therefore not as smooth as we would have wanted. I understand however that there was a significant improvement in account opening standards, documentation, and reporting in the following years as the centralized system came into effect, which gave HBMX a better platform to establish enhanced control on account opening and remediate historic accounts. Decisions were made to put strict limits on the U.S. dollar business we do in Mexico, we closed branches in areas where we believe there is a high risk of money laundering, and we are now in the process of closing all the HBMX Cayman accounts. The Group will continue to scrutinize our business there to determine how we can further mitigate compliance risk.



Many of the specific challenges I faced during my tenure, and the actions that I took, will likely be outlined more fully in your report. I will answer your questions to the best of my ability based on my time on the ground in Mexico, as I did with your staff several weeks ago.

### **III. Lessons Learned**

We have learned much from our experience in Mexico, and I would like to discuss briefly some of what I consider to be the key lessons.

First, when a problem arises, it is imperative to do the right thing and to do it quickly. During my tenure in Mexico, I tried to follow this rule. For example, in response to compliance failures, I fired individuals involved in falsifying KYC records and announced a zero tolerance policy for similar conduct, and we closed customer accounts, despite the risk of adverse reaction. The Group is taking firm action today to close down businesses where the risks cannot be effectively managed, regardless of the impact on short term profitability, and have invested in increased compliance resourcing.

Second, business expansion cannot be allowed to run ahead of putting in place appropriate controls and infrastructure. Without adequate controls, financial institutions face severe business and operational risks that are simply unacceptable. In retrospect, it is clear that in Mexico, the Group was overly optimistic about our ability to bring up to standards quickly an acquired entity that had little to no compliance and operational infrastructure when we acquired it. The Group today is working hard to reduce its complexity and risk profile, and to empower Global Functions, including Risk and Compliance, to have direct oversight of the key controls across our business.

Third, operational and compliance risk cannot be addressed by systems and process alone. In Mexico, we made little progress by simply installing Group systems and creating

control functions until we addressed the culture of the bank and the underlying business model. Cultural change takes time, but getting the tone at the top right, and changing performance management systems and rewards, are critical drivers to achieving higher standards.

Fourth, when challenges arise, we must share information broadly across the Bank. During my tenure in Mexico, information at HSBC flowed vertically but not horizontally. The Subcommittee is right to note that, as a result, a number of risks and challenges we faced in Mexico were not fully appreciated by our counterparts in other parts of the Group. We are changing this through formal reporting structures to ensure that we maximize the sharing of information for risk management purposes amongst Group companies and amongst Global businesses and functions.

Finally, we cannot be afraid to acknowledge and learn from our mistakes. We have directly acknowledged our shortcomings in Mexico and in the United States, and our Group CEO has set a clear policy that requires all parts of the Group to adopt and enforce a single global standard that is determined by the highest standard that must be applied *anywhere* and also requires us to maximize information sharing across the Group. This will help make us a better bank that effectively manages risk consistently on a global basis.

#### **IV. Conclusion**

Criminals operate globally and if we are to combat them and stop them from accessing and abusing the financial system, we must look at issues from a global perspective. Institutions which operate internationally, like HSBC, will be targeted by these criminals, and our experience in Mexico vividly demonstrates that you are no stronger than your weakest link. We have to be sure that we have the best and strongest defense in place, in every business, in every market in

which we operate, regardless of the local challenges. It is for this reason that I appreciate the opportunity to speak with the Subcommittee today.

It is clear to us all that our anti-money laundering controls should have been stronger and more effective, and that we fell well below the standards that we should have achieved. We have co-operated fully with the PSI and other authorities to ensure that we learn from the mistakes that were made in the past.

We are determined that drug dealers, terrorists, and all forms of criminals will not access the financial system through HSBC. The Group management team is committed to ensuring that we meet the highest standards in every aspect of our business in the future.

**Michael Gallagher**  
**Former Executive Vice President**  
**HSBC BANK USA, N.A.**  
**Written Testimony for Senate Permanent Subcommittee on Investigations**  
**July 17, 2012**

Chairman Levin, Ranking Member Coburn, and Members of the Subcommittee:

My name is Michael Gallagher and I reside in Lincroft, New Jersey. From 2001 until last year I was an Executive Vice President at HSBC Bank USA, N.A. ("HBUS") responsible for Payments and Cash Management ("PCM"), North America. On November 21, 2011, I was subject to a reduction in force at the bank.

Anti-money laundering, terrorism financing, and global access to the U.S. financial system are issues of critical importance to the banking industry and to national security. I have prepared this written statement in order to address certain areas of inquiry outlined in the Subcommittee's correspondence dated June 29, 2012, and I will be pleased to answer any additional questions at the hearing that the Subcommittee might have.

During my tenure at HBUS, PCM developed and marketed payments and cash management services to corporate and middle market clients as well as financial institutions, including HSBC affiliated banks. At the time of my departure, there were five regional heads of PCM, including me, each of whom reported to the global head of PCM. I generally had four teams within PCM that reported to me: sales, product management, client services, and central services.

In addition, there were two periods of time during my tenure at HBUS when Wholesale Payments Operations (the team responsible for wire transfers) reported to me: approximately 1998 to 2001 and approximately 2004 to 2007. Within its operations function, HBUS had a payments filter that was programmed to detect and flag transactions from sanctioned countries,

among other things. The payments processing team within operations would review each of the transactions stopped by the filter. To the best of my knowledge, if the transaction required further evaluation, it would be escalated to the Compliance department.

In regard to the Subcommittee's interest in U.S. dollar transactions involving Iran, I recall that in approximately May 2001, I was informed by the head of Wholesale Payments Operations of a business proposal under consideration by HSBC Bank plc to provide U.S. dollar clearing services to Bank Melli, an Iranian bank. I responded to her, copying my manager, the head of Corporate Banking, stating that I was not comfortable with the bank's pursuit of such a business arrangement. I was concerned with the regulatory, reputational, and operational risk associated with this business proposal, and particularly the fact that Bank Melli was unwilling to identify the main beneficiaries of the payments at issue. The head of Wholesale Payments Operations then forwarded my concern to the Compliance department. I was not privy to the outcome of the discussions regarding the Bank Melli proposal.

I also understand that the Subcommittee is interested in the Global Banknotes business. In approximately early 2007, the Head of Global Banking and Markets asked if I would take on managerial oversight of Global Banknotes and serve as someone to whom Christopher Lok, the Head of Global Banknotes, could report. HSBC's Banknotes division bought, sold, and shipped banknotes around the world on behalf of its clients. HSBC had several banknotes vaults, including vaults in New York, London, Frankfurt, Tokyo, Singapore, and Hong Kong.

Finally, I understand that the Subcommittee is interested in HBUS' anti-money laundering, or AML, efforts. During my tenure at HBUS, although the Compliance department was primarily responsible for HSBC's AML efforts, my team and I took compliance matters very seriously. PCM assisted the Compliance department, as well as relationship managers, with

regard to AML and related compliance efforts. In instances when PCM became aware of negative information regarding a client, PCM worked closely with the Compliance department to ensure that it received the information it needed. PCM also made resources available to the relationship managers and the Compliance department to assist in any way that we could.

In summary, I would like to thank the Chairman and Subcommittee for allowing me to speak at the hearing on these critical matters. HSBC, and the banking industry as a whole, have learned a lot over the past decade or so. I believe that HSBC's experience can add value to understanding more broadly the risks and opportunities for enhanced safety in this industry. During my tenure at HSBC, there were steps taken to tighten anti-money laundering controls. But, with hindsight, it is clear that we did not always fully understand the risks of our business, and that we could have done much more, and done it more quickly. I appreciate the opportunity to provide this information to the Subcommittee. I am prepared to answer any additional questions that the Subcommittee may have during the hearing.

**Testimony of Chiu Hon "Christopher" Lok**  
**Before the United States Senate**  
**Permanent Subcommittee on Investigations**  
**July 17, 2012**

Chairman Levin, Ranking Member Coburn, and members of the Subcommittee, I appreciate the opportunity to be here today. My name is Christopher Lok, and from 2001 until 2010 I served as the global head of the Banknotes business at HSBC.

In my statement today, I will cover three topics. First, I will provide my background information. Second, I will provide an overview of the Banknotes business at HSBC. And third, I will address some of the specific problems and issues that I believe the Subcommittee is interested in. For me, it is painful and embarrassing to talk about the areas where, in hindsight, we fell short. At the same time, it is valuable to do so in order to find constructive solutions and so that others don't make the same mistakes going forward.

I was born and raised in Hong Kong. In 1981, I started working in the Banknotes business, and that is what I did for 29 years. During the entire time from 1981 through 2010, I worked for HSBC or a predecessor institution. For most of my career I was based in Asia, but I was privileged to have lived and worked in New York for a brief period in the 1990s and again from 2001 until 2010. Even though I am not a U.S. citizen, I had a wonderful experience living and working in this country and I have a great admiration and affection for the United States.

I'd like to provide a brief overview of the Banknotes business. In essence, the business is about the buying and selling of physical currency at the wholesale level. Our clients were banks and other financial institutions all around the world. We employed about 275 people, including

traders, back office staff, and people who focused on operations and logistics. We dealt with approximately 800 customers, in over 100 countries, and we transacted in about 75 different currencies. These customers have natural demand for and supply of currency banknotes, driven by various economic activities. To them, HSBC was a safe and reliable counterparty and I believe that we provided them with a valuable service.

I understand that the Subcommittee is focused on some of the compliance challenges that we faced in the Banknotes business.

Let me start by emphasizing that compliance was a critical part of the HSBC Banknotes business. Over a period of years, there were some occasions when I communicated with my colleagues in compliance in a manner that was unnecessarily aggressive and harsh. These communications were unprofessional, and I deeply regret them. In reality, the business line and compliance shared the same objective – to avoid the bank being used by inappropriate people for improper transactions. Despite my overly critical emails, I believe Banknotes business and compliance people actually had a good working partnership. While I didn't always communicate this, I had great respect for my colleagues in compliance and I valued their work.

With respect to Banknotes transactions with customers in Mexico, up until December 2008 I was under the impression that HSBC's Mexican affiliate, HBMX, was operating under HSBC group standards. In December 2008, HBMX announced that it would no longer be accepting U.S. currency in Mexico. I was surprised by this announcement, and I tried to find out what was the reason behind it. It was not until early 2009 that I learned, as a result of my own inquiries, that HBMX had gotten into problems because their anti-money-laundering controls were seriously compromised. I was surprised and concerned about this news. I was not



previously aware of the AML problems at HBMX. If we had known of these problems, I am certain we in the Banknotes business would have done things differently.

As time went by, some questions were raised about the Banknotes business in Mexico. In retrospect, we did not adequately appreciate the concerns being raised about the business environment in Mexico. While we did our best to deal with these inquiries, I am sorry to say that I did not understand what later became apparent. With the benefit of hindsight it is now clear that we did not perceive the extent of the anti-money-laundering deficiencies and the risks present in Mexico.

Thank you very much.

**Irene Dorner**  
**President and CEO**  
**HSBC Bank USA and HSBC North America Holdings, Inc.**  
**Written Testimony for Senate Permanent Subcommittee on Investigations**  
**July 17, 2012**

**I. Introduction**

Thank you Chairman Levin, Senator Coburn, and members of the Subcommittee. My name is Irene Dorner and I serve as President and CEO of HSBC Bank USA ("HBUS") and HSBC North America Holdings, Inc. ("HNAH"). I have led the Bank in the U.S. since January 2010. This is one of the many entities across the globe that forms HSBC Group, which is headquartered in London.

At the outset, let me state clearly that we deeply regret and apologize for the fact that HSBC did not live up to the expectations of our regulators, our customers, our employees, and the general public. HSBC's compliance history, as examined today, is unacceptable. Therefore, I fully appreciate why we are here and believe that this is an important discussion. HSBC has learned some very hard lessons from the experience of the past few years. But we have taken very substantial steps to address the problems that we, our regulators, and this Subcommittee have identified. We have made fundamental changes in governance, culture, training, and funding to ensure that we can effectively deter illicit use of our bank. These changes will be embedded and sustained going forward.

As you know, these issues and challenges do not end at the water's edge. So we are combining our efforts with reforms that apply throughout HSBC's global business. And I am joined today by our new Chief Legal Officer, Stuart Levey, who is here on behalf of the HSBC Group and who will describe HSBC's global compliance commitment. Stuart and I sit on HSBC Group's new Global Standards Steering Committee that is charged with establishing a uniform

set of high standards for all HSBC affiliates around the world. I sit on this Committee because senior leadership at HSBC Group recognizes that often U.S. standards will be the highest standard globally. We have taken the lessons we learned from our experiences in the U.S. and are applying them on a global basis.

Today, I would like to address two topics. First, I would like to tell you about HSBC and describe the importance of an effective compliance program to an institution of our size and global reach. Second, I would like to talk about the work we have done to address our AML Compliance deficiencies.

## **II. HSBC in the United States**

HSBC is in a unique position: we are among a handful of financial institutions with a truly global footprint. HSBC entered the United States in the 1980s when we acquired Marine Midland Bank and we have been building on this foundation ever since. Today, our U.S. business has 16,500 employees and serves about 3.5 million customers. We have four main business lines: Global Banking and Markets; Retail Banking and Wealth Management; Commercial Banking; and Private Banking.

HSBC has a truly global footprint. Our customers have a need for global banking services. In the United States, HSBC is one of the largest dollar clearers; this is important because the U.S. dollar is the currency of trade and commerce virtually no matter where you are. When a U.S. manufacturer wants to sell its products to a retailer in Hong Kong, the transaction is settled in U.S. dollars. When a manufacturer in Singapore sells its goods to a purchaser in Germany, or a raw materials supplier in Brazil sells its products to a purchaser in Canada, chances are those transactions are settled in U.S. dollars as well.

This global reach gives us a tremendous opportunity to attract customers who are internationally focused. But it also brings with it a tremendous responsibility. Given my experience working for HSBC in other parts of the world, I am cognizant of the risks and obligations that come with serving our customers. At an absolute minimum, we must have the proper controls and systems in place to ensure that we are doing the right business, in the right places, with the right customers, and that our customers' transactions are properly monitored. If for any reason a transaction appears to be unlawful or suspicious, then we scrutinize the customer and report this information to the authorities in a timely manner.

In the world of banking, there is nothing more important than our reputation, not just for financial strength but also for trustworthiness and integrity. Not only is it important to our customers and our regulators, it's important to me, and it's important to my management team. I have made clear that I expect every member of my senior management team to stand up for doing what is right.

### **III. AML Compliance Remediation**

As the subcommittee has documented, we have fallen short in a number of serious ways. In October 2010, the U.S. bank entered into a Consent Order with the OCC. The OCC criticized various aspects of the Bank's AML program, including failure to provide adequate resources for our AML Compliance function, gaps in automated monitoring of certain wire transfers and banknotes transactions, failure to conduct due diligence on our own HSBC affiliates, and an inadequate process of risk-rating certain customers. We had not invested what we should have in our AML resources and systems. With the full support of our Board and of HSBC Group, I took the lead in overseeing our remediation efforts, and we have taken significant steps forward.

I want to turn now to highlight several of the changes we have implemented.

**A. People and Culture**

We've worked hard to foster a new culture that values and rewards effective compliance, and that starts at the top. By the end of 2010, we had a new U.S. senior management team in place, including myself as CEO, a new General Counsel, a new Head of Compliance, and a new AML Director. Previously the role of General Counsel and head of Compliance had been combined under one person. We also elevated the role of the AML Director, who now reports directly to the Chief Compliance Officer and regularly reports directly to the Board and senior management about the AML program. The Chief Compliance Officer and AML Director also have an independent line to a non-executive member of our Board of Directors.

We have improved the quality, coverage, and strength of our AML program through additional staffing and training. We have worked to build an AML team that has the right subject matter expertise and the right operational expertise.

The U.S. bank has made significant investments in our AML Compliance program over the past two years. We increased AML Compliance spending to \$244 million in 2011, approximately nine-fold what we spent in 2009. A big part of this investment has been in hiring and retaining the right people: today we have about 892 full-time AML Compliance professionals. This includes our monitoring and alert review team, local compliance officers, Financial Intelligence Unit team, sanctions screening team, and other AML subject matter experts.

**B. Policies and Procedures**

Another area we needed to address was that we did not adequately appreciate the risks of our businesses and of our customers. In early 2010, the HNAH Board undertook an enterprise-wide risk assessment and made the decision to exit or scale back several businesses that we

decided presented significant compliance risk. Since 2010, we have closed down the Banknotes business, we have exited about 28 embassy banking relationships, and we have closed 326 correspondent banking relationships. This is an ongoing process – we continue to do a formal Enterprise Risk Assessment twice a year to ensure that we are properly managing our risk enterprise-wide.

We also needed to make changes to our Know-Your-Customer (“KYC”) policies. We had previously not been doing customer due diligence on our own HSBC affiliates. We now do the same level of customer due diligence on our own affiliates as we do on third-party customers. We have also improved the way we approach customer diligence for all our customers. We have developed and implemented new bank-wide KYC standards that apply to all our business lines to ensure consistency. Our new KYC policy forces a more critical look at each customer at the onboarding phase, which enables us to make better decisions about whether that customer fits within our risk appetite.

I firmly believe that KYC is about more than just checking a box – it’s about really understanding who your customer is so that you know whether this is a customer you want to do business with. Importantly, we are enforcing this message across our entire employee team through robust and continual training, outreach, and communications.

We also developed a new country risk-rating methodology, as well as a new customer risk-rating methodology. The new customer risk-rating methodology takes a holistic view of customer risk, evaluating risk based on country of residence, products and services utilized, legal entity structure, and type of business or customer. We now have a better way of identifying where our risks lie and we can make good decisions about whether we have the right controls

and the right level of diligence on a particular customer, and if we do not, we will either fix it or we will exit that customer.

Once we had our new customer risk-rating methodology and KYC policy in place, we started rolling out a large-scale KYC remediation project across all our business lines, which I chair. Through this process, we have been reviewing our entire customer base, exiting certain customers, and remediating all our remaining customers up to our new KYC standards. Our KYC remediation project is a huge undertaking and this project has integrated our business people with our Compliance people in a way that did not happen before. Many of the changes we are making are being adopted as HSBC global best practices.

### **C. Technology**

We also needed a more robust transaction monitoring system that was sustainable and had the right controls. We have made significant investments in technology and we believe that our new transaction monitoring system more effectively detects suspicious activity. We have also built better controls around that system so that any changes to the way we monitor are vetted by an independent team.

In addition to improving our technology, we recognized that we needed the right structure around the technology so that we not only get better alerts, but are better able to analyze those alerts and report suspicious activity to law enforcement. So we looked not just at the numbers of analysts we needed to hire but the types of people we needed. We brought more subject matter experts into our monitoring team and have built out our Financial Intelligence Unit.

While we have made real progress, we recognize that there is more to do. This is difficult, it is complicated, and it takes time to do it right. Our regulators recently raised issues about some aspects of our model validation process. Addressing these issues is a top priority.

**IV. Sustainability**

We understand that we have to rebuild the trust of our regulators, our customers, and our other stakeholders. For this reason, the sustainability of our AML Compliance program is a top priority. The intended consequence of the changes I have discussed is to embed a new culture of responsibility, accountability, and deterrence within the U.S. bank. In many ways, an organization's culture is a product of the "tone at the top," and it has been my mission, and the mission of my new senior team, to make sure that compliance is on every employee's mind at every level in the organization.

We understand that an effective AML Compliance program requires an ongoing process of learning, adapting, and improving. There is no point at which we can just sit back and say, "Our program can't get any better." We need to evolve and improve constantly; we need to respond not only to regulatory changes but also to advances in technology and to the risks posed by the ingenuity of drug traffickers, money launderers, tax evaders, and others seeking to use our financial system for illicit purposes. We want our doors to be closed to these bad actors. We will never catch every single illicit transaction, but our goal must be to ensure that we are in the best position possible to do so. This is my goal and commitment, and this is the goal and commitment of the HSBC Group, supported fully by our Board of Directors. My commitment also extends to the thousands of HSBC employees here in the U.S. who have been working tirelessly over many months to remediate compliance issues and create a sustainable compliance capability.

**V. Conclusion**

In closing, let me say that I appreciate this Subcommittee's efforts to examine and improve the steps taken by industry and government to address these challenges, and we are committed to fulfilling our responsibilities in an effective and sustained manner.



**Stuart Levey**  
**Chief Legal Officer**  
**HSBC Holdings plc**  
**Written Testimony for Senate Permanent Subcommittee on Investigations**  
**July 17, 2012**

**I. Introduction**

Good afternoon Chairman Levin, Ranking Member Coburn, and members of the Subcommittee. My name is Stuart Levey and I joined HSBC Holdings plc (or "Group") as its global Chief Legal Officer in January of this year. I am pleased to appear here, at the Subcommittee's request, to participate in today's hearing on combating money laundering. This Subcommittee has played a vital role in promoting sound policies and practices in the AML area. That work has made the global financial system stronger and increased the tools available to law enforcement in the campaign against those who would misuse the global financial system for money laundering, drug trafficking, terrorism, tax evasion, or other illicit purposes.

We have worked closely with the staff during the course of the investigation and cooperated as completely as possible to help provide a full picture of what happened. This process has highlighted some unacceptable shortcomings that HSBC deeply regrets. We have learned from this experience and are taking steps to change.

Irene Dorner, our U.S. CEO, has spoken about the work we have done and continue to do to improve our AML compliance controls in the United States. However, we recognize that it is not enough to fix the specific issues that the Subcommittee has focused on; instead, we must implement a global strategy to tackle the root causes of our identified deficiencies. That is what we have begun to do and that is what I would like to talk about today.

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**II. Lessons Learned**

We have learned some difficult lessons from our experiences in the U.S. and in Mexico. We have learned that our decentralized management model focused on country heads made it difficult to ensure that HSBC standards were being implemented consistently. While our old model served us well historically, it does not work in an interconnected world where transactions cross borders instantaneously and where weaknesses in one jurisdiction can be quickly exported to others. New acquisitions expanded HSBC faster than our infrastructure and controls could handle, especially given increasing regulatory expectations. In some instances, acquisitions were not sufficiently integrated into our operations and not brought up to HSBC standards quickly enough. We have learned, therefore, that HSBC affiliates could not assume that other HSBC affiliates with whom they did business were adhering to adequate standards. We have learned that our approach to compliance – and AML in particular – was not adequate to address the risks we face as a global institution. And we have learned that we did not share information effectively enough across our affiliates, with serious consequences.

**III. How We Are Reforming HSBC To Address These Shortcomings**

At the beginning of 2011, there was a transition at HSBC to our new CEO, Stuart Gulliver, and our new Chairman, Douglas Flint. The new leadership team recognized that immediate action was required and set out a strategy to make changes to the way HSBC operates around the world. Over the past eighteen months we have taken concrete steps to address each of the deficiencies I have described. The work we have undertaken is ambitious and complicated given our size and our global footprint, but we all recognize that it must be done.

**A. Reorganization of HSBC's Structure and Business****1. Global Businesses and Functions**

In early 2011, our new CEO, Stuart Gulliver, articulated the firm's new strategy. The decentralized system where country heads were dominant on all matters within that country would be eliminated and replaced. Instead, in order to make the firm more cohesive and better connected, we reorganized HSBC into four Global Businesses and ten Global Functions in addition to our pre-existing regional structure. We gave the heads of each business and function the authority over all personnel in their respective organizations all over the world, thus creating the ability to manage their business or function on a global basis, making it easier to implement consistent policies, standards, and processes. The Global Businesses are Global Banking & Markets ("GBM"), Commercial Banking ("CMB"), Private Banking ("GPB"), and Retail Banking and Wealth Management ("RBWM"). The Global Functions include Legal, Audit, and Risk and Compliance. The heads of each of the businesses and functions, together with the heads of each of the regions, are all members of our risk management committee, which is part of the Group Management Board. This group meets eleven times a year and each meeting is comprehensive, often lasting an entire day. What that means is that the most senior people responsible for managing HSBC globally sit around a table every month, look at our risks, and make decisions.

Better global integration makes us better situated today to manage our risk on a global basis, better able to see where risk in one part of HSBC may impact another part, and better able for the first time to ensure that consistent compliance standards and practices are implemented across all of our affiliates.

## 2. Simplifying Our Business

In May 2011, we announced a second key component of our new strategy. We have put the entire business through five economic filters: international connectivity, economic development, profitability, cost efficiency, and liquidity. Businesses that do not fit are sold; countries that do not fit are exited. We are no longer trying to be everywhere and trying to provide all services to all customers. We have focused on selling or exiting non-core businesses, which added undue complexity and raised control risks. (An early example of this would be the Mexican U.S. dollar cash handling business that was terminated by our former CEO Michael Geoghegan in 2008. Eventually, the global Banknotes business was closed entirely.) Application of these filters was designed to make the firm more manageable, reduce risk, and focus on our strengths as an internationally connected bank. As a result, over the past 18 months, we have sold or exited 31 businesses and are withdrawing from 9 countries.

We believe that this new structure and focus allows us to more effectively manage HSBC on a global basis and puts us in a better position to both detect and address compliance risk globally.

### **B. Increased Focus On Compliance**

Historically, Group Compliance served what was primarily an advisory function. Compliance in each country reported to the country CEO and implementation of HSBC standards was the responsibility of each local Compliance group. This led to inconsistency and in some cases confusion about ownership and escalation responsibility. The top Group Compliance job at HSBC, which David Bagley has held for the past ten years, is undeniably difficult and our historical organizational structure meant that we did not invest in Group Compliance or empower it the way we should have. This has changed.

### 1. Strengthening Compliance

We have elevated and strengthened the role of Group Compliance so that it is now a key control function, not just an advisory function. The Head of Group Compliance now has authority over the nearly 3,500 HSBC compliance officers worldwide. Group Compliance is responsible for resourcing decisions, performance reviews, objectives, strategy, budget, and accountability within all the Regional and Global Business Compliance functions, as well as compensation for all Compliance officers globally. Under the new structure, Group Compliance is empowered to set standards across the organization and now has the necessary authority to reach down into affiliates and ensure that those standards are being met.

We have significantly increased the resources devoted to Compliance across the firm. We have created a new independent Assurance team within Compliance that reviews the effectiveness of the Regional and Global Business Compliance functions, reports compliance issues for remediation, and tracks progress. We now have the tools to analyze and assess our affiliates, looking for compliance risk and problems, and to raise those up to senior members of Group Compliance and Group Risk, who are now responsible for ensuring problems are resolved. This gives us a transparency and accountability that was lacking before.

In addition to shoring up our Compliance function, we have also enhanced the authority of our Global Risk function, so that it too is a strong control function that works in tandem with Compliance. Our Chief Risk Officer now has a broader mandate to control all types of risk globally and has oversight over every Risk officer in every affiliate. The Chief Risk Officer chairs the Risk Management Committee meetings and attends the full Group Holdings Board meetings, at which risk and compliance is a substantial focus.

## 2. Values Program

In addition to adding resources and elevating the stature of Group Compliance, in 2011 our new senior leadership introduced a values program that seeks to define the way everyone at HSBC should act. Under this values program, before any consideration of the business scorecard, our top executives are judged on being open, connected, and on their commitment to acting with integrity. In addition, all managers and senior executives are accountable for ensuring that business decisions and activities within their area are aligned to our values and business principles. This includes reviewing all products, services, policies, and practices to ensure that the values are embedded into our “business as usual” operations. Employees also are expected to understand the impact of the values and business principles on their day-to-day activities and, as part of performance reviews, employees are now assessed on their value-related behaviors. The compensation of all HSBC employees – from the most senior to the most junior – will be impacted if behaviors do not meet our expectations.

So far, 332 senior managers have attended a 2-day workshop on HSBC values; 3,000 executives have attended leadership training, and 43,500 employees have attended general training, both of which included sessions on HSBC values.

## 3. New Chief Legal Officer

It was in the context of these reforms that HSBC’s leadership approached me about taking on a newly-created position of Chief Legal Officer. I had previously served nearly seven years as the Under Secretary of Treasury for Terrorism and Financial Intelligence under Presidents Bush and Obama. In our conversations, the Chairman of the Board and the new CEO were candid with me about the problems HSBC faced, the reforms they wanted me to help them implement, and the empowerment that I would need and have. I saw the opportunity as an

important challenge. HSBC is a great institution with a global footprint and tremendous scale. Helping HSBC successfully implement the kinds of reforms I am describing today will make a significant difference in promoting the overall integrity of the financial system.

### **C. Designing and Implementing New Global Standards**

In April of this year, Stuart Gulliver issued a Group Circular Letter (“GCL”) – which is the way our CEO communicates important policy changes throughout the Bank – entitled “HSBC Global Standards.” This directive states that in order to preserve and enhance our reputation, we must lead our industry in formulating and implementing global standards and controls to ensure that our conduct matches our values. The GCL sets forth some key principles. These are, among other things, that HSBC must:

- Adopt and enforce adherence to a single standard globally that is determined by the highest standard we must apply anywhere. Often, this will mean adhering globally to U.S. regulatory standards, but to the extent another jurisdiction requires higher standards, then that jurisdiction’s requirements must shape our global standard;
- Maximize the sharing of information for risk management purposes among Group companies and among Global Businesses and Functions;
- Apply a globally consistent approach to knowing and retaining our customers. When we conclude that any customer or potential customer poses an unacceptable reputational risk (or otherwise does not meet our standards), we should exit or avoid the relationship globally.

The GCL also established a new Steering Committee on Global Standards, co-chaired by myself and our Group Chief Risk Officer, which is responsible for developing and overseeing the implementation of the new standards. Irene Dorner is also a member of the Committee,

because we recognize that often the highest standards will be U.S. standards and Irene's experience and expertise in that area will be invaluable. This will mean that rather than the U.S. bank being faced with the challenges of absorbing problems and deficiencies from abroad, more often than not it will be high U.S. standards that we will be exporting globally. By implementing this highest common denominator approach across HSBC we are requiring that all our affiliates be held to consistent high standards. Our new structure gives Group Compliance and our other control functions the ability to hold people accountable for following those standards in a way that was not possible before.

Our Global Standards Steering Committee has already taken action on a number of issues, and we have purposefully set out to address several of the problems the Subcommittee has highlighted through its investigation.

1. Information Sharing

One of the first acts of the Steering Committee was to enact a new global standard designed to maximize the sharing of information, to the extent permitted by law, across all HSBC affiliates and all Global Businesses and Functions for risk management purposes. Key compliance-related information will now be shared horizontally with all Regional and Global Business Compliance Heads, including monthly reports detailing compliance issues in a region or business line. The reports from the new Assurance team's on-the-ground reviews of specific Regional Compliance Functions will also be shared horizontally. And importantly, any material or systematic AML control weaknesses at one affiliate are to be shared with all affiliates. Similar information sharing protocols have been established for affiliate audit reports. We have seen what happens when information is not shared effectively across our institution, and we



continue to look for additional opportunities to increase the flow of information throughout the firm.

One difficult reality that global institutions like HSBC have to grapple with is that we face certain restrictions on sharing information across borders because we must adhere to the law wherever we operate. The Subcommittee is well aware of this issue and the challenges we face in this area. But at the same time we have recognized that we can significantly improve the flow of information from what occurred in the past and thereby improve our controls.

The Steering Committee is also overseeing the establishment of a global Financial Intelligence Unit ("FIU") at the Group level to ensure we are able to analyze and act on information submitted from around the firm and, subject to any legal restrictions, to share information with relevant affiliates that are impacted.

## 2. Affiliate Due Diligence

Another early action of the Steering Committee was to globalize the practice of conducting appropriate due diligence on all of our HSBC affiliates. The risk of not doing so has been clearly illustrated by this investigation. While affiliate due diligence is only required by law in a few countries (and is not required by the Financial Action Task Force), we believe that best practice mandates that HSBC affiliates should know *more* about each other than they do about third-party customers, not less. This means that all HSBC affiliates are now required to complete due diligence on any other HSBC affiliate with which they have a correspondent banking relationship.

## 3. Global Risk Filter

In addition to the five business filters discussed above, the Steering Committee has decided to add a sixth filter to govern HSBC's activities in high risk jurisdictions. We are

implementing a new global risk filter that will standardize which countries are viewed as high risk by adopting the U.S. country risk ratings on a firm-wide basis. The risk filter will help us determine what business we are comfortable doing in high risk places and what business we must avoid. We *want* to be in fewer places, with fewer clients, and with less risk across the board. Because the risk filter will be applied firm-wide, it will also bring consistency and enhance our ability to understand and manage our risk across affiliates. We do not view this as sacrificing business for compliance purposes. There is no conflict between our business objectives and compliance objectives in the long run or when viewed from a global firm-wide perspective.

#### 4. Global Sanctions Policy

The Steering Committee has also moved to adopt a global sanctions policy, based on a review of HSBC's current payment screening policies and procedures. We have identified a number of enhancements that can be made to that process, including additions to the sanctions lists used for both "real time" and "near time" payments screening. Among other things, this will mean that we will be screening for all illicit actors designated by OFAC in all jurisdictions, in all currencies.

#### IV. Making Reforms Sustainable

We understand that we also need a genuine commitment from the highest levels of the organization to institutionalize the reforms and foster a culture of compliance. That is being accomplished in part by formalizing the reforms I have described and embedding them in a governance structure.

In the end, sustainability of these reforms depends critically on the commitment of HSBC's top leadership. The tone at the top of HSBC is, in my view, remarkably strong. Our

Board and senior leadership are committed to seeing these reforms through, and we understand that this is something that absolutely must be done for the long-term success of our bank.

**V. Protecting the Integrity of the Financial System**

The reforms I have laid out above, when fully implemented, will have a positive impact on the financial system. But beyond that, there are opportunities to improve collaboration both among financial institutions and between the financial sector and the government that would help protect the financial system from misuse. One lesson I learned during my Treasury service is that, in almost all cases, the private sector and governments share the same goals when it comes to preserving the integrity of the financial system. This is a difficult problem, and we are up against groups of people who are adept at evading controls. My experience at Treasury was that banks are eager to receive the type of information about illicit conduct that the government is able to provide and to engage with the government about mitigating that risk, and this is certainly true with respect to HSBC. HSBC wants to play a constructive role in this effort, and there are clearly opportunities for increased information sharing and collaboration.

This Subcommittee helped create a valuable tool in the PATRIOT Act when it gave the industry 314(b), which permits financial institutions to share information with one another in order to identify and report to the federal government activities that may involve money laundering or terrorist financing. Increased sharing of such information would enable financial institutions – and law enforcement – to better connect the dots, identify suspicious patterns of activity, and take appropriate action. Unfortunately, this provision has not been used as robustly as it might be. I know this Subcommittee has also been looking for ways to improve the effectiveness of this provision.

Another potential area for improvement is the sharing of information between financial institutions and government agencies. Law enforcement agencies and the intelligence community collect and analyze significant amounts of information regarding illicit activity, which often enables the government to identify the names of individuals, companies, or other entities that facilitate or tolerate illicit activity. This information would be extremely valuable to financial institutions, and to the extent more of this information could be shared, that is something we at HSBC, and I am sure others in the industry, would support and encourage.

Along these lines, it would be helpful to have more access to beneficial ownership information for companies. Provisions of the Levin-Grassley Incorporation Transparency and Law Enforcement Assistance Act would be a step in the right direction, particularly if beneficial ownership information were to be made more readily available not only to law enforcement but to financial institutions as well. The better banks know their customers, the more secure the entire system is from misuse.

#### **VI. Conclusion**

You have heard a lot today about what happened in the past and the reasons for it. We are in the process of applying the lessons learned from our experience throughout our institution. We have a long way to go on this journey, but I believe we are on the right path. We have work to do to regain the trust of our regulators, our customers, and other stakeholders. But I do want to say very clearly that the reforms we are undertaking reflect a real commitment to HSBC's true values. HSBC is a bank that has a long and proud heritage. Over its 147 year history HSBC has been an upstanding corporate citizen all over the world and has played a vital role in integrating emerging markets into the global economy. This is a bank that has helped thousands of individuals and small businesses realize their dreams.

This experience has been a very painful one for the vast majority of the HSBC family who have spent their careers at the bank doing the right thing every day. I know I speak for all of HSBC senior management when I say that we are committed to doing what needs to be done. I appreciate the opportunity to speak to you today and I look forward to answering your questions. Finally, Mr. Chairman, I intend to answer the Subcommittee's questions as candidly and completely as I can today. However, as has been previously discussed with the Subcommittee's staff, there are certain potential questions – or parts of questions – that I may not be able to answer because of either legal obligations attendant to my prior position in Government or ethical obligations associated with my present position as counsel for HSBC. I hope that none of today's questions will implicate either of these areas where I cannot respond, but if they do I will let you know.

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For Release Upon Delivery  
9:30 a.m., July 17, 2012

**TESTIMONY OF**  
  
**THE OFFICE OF THE COMPTROLLER OF THE CURRENCY**  
  
**Before the**  
  
**PERMANENT SUBCOMMITTEE ON INVESTIGATIONS**  
  
**of the**  
  
**COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS**  
  
**of the**  
  
**U.S. SENATE**  
  
**July 17, 2012**

Statement required by 12 U.S.C. 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

## **I. Introduction**

Chairman Levin, Ranking Member Coburn, and members of the Subcommittee, the Office of the Comptroller of the Currency (OCC) appreciates the opportunity to appear before you today to discuss the importance of effective Bank Secrecy Act (BSA) compliance programs at U.S. financial institutions and the role the OCC – and the other financial institution regulators – play in examining financial institutions for compliance in this area. As well, this testimony focuses on the OCC's supervision of HSBC Bank USA, N.A. (HBUS or Bank) with respect to BSA compliance, our enforcement action against the Bank, and other matters in which the Subcommittee has expressed an interest.

The OCC is committed to ensuring that the institutions under its supervision have effective controls in place to safeguard them from being used as vehicles to launder money for drug traffickers and transnational and other criminal organizations, or facilitate the financing of terrorist acts. Together with the other Federal banking agencies, the banking industry, and the law enforcement community, the OCC shares the Subcommittee's goal of deterring money laundering, terrorist financing, and other criminal acts and preventing the misuse of our nation's financial institutions.

National banks and thrifts have been required to have a BSA compliance program since 1987, and to monitor, detect and report suspicious activity since the 1970s. However, regulatory requirements and supervisory expectations under the BSA have increased significantly since that time, with the result that most institutions have had to make substantial improvements in their BSA compliance programs. In response, many of the largest institutions have implemented highly sophisticated programs and systems that screen transactions to identify and report suspicious activity to law enforcement, and to ensure that such transactions do not involve entities subject to Office of Foreign Assets Control (OFAC) sanctions. The suspicious activity reports (SARs) that are filed have provided law enforcement with access to critical information needed to initiate and conduct successful investigations and prosecutions. There are now approximately 5.6 million SARs in the centralized database that is maintained by the Financial Crimes Enforcement Network (FinCEN). The majority of these SARs have been filed by national banks and thrifts.

However, as our financial institutions' BSA compliance programs have evolved and changed over time, so has the sophistication and determination of money launderers, terrorist financiers and other criminals in finding other ways to gain access to our financial institutions. The technology, products and services offered by our institutions to give customers better and quicker access to financial services also are being used by criminals to instantaneously and anonymously move money throughout the world, sometimes through the simple click of a keypad. Consequently, banks, thrifts, and other financial institutions have had to devote increasingly larger amounts of resources to maintain effective programs.

Comptroller Curry recently spoke on the operational risks that are challenging financial institutions. One of the areas he spotlighted was BSA compliance. He noted that BSA compliance is inherently difficult, combining the challenges of sifting through large volumes of transactions to identify features that are suspicious, with the presence of criminal and possibly

terrorist elements dedicated to, and experts in, concealing the true nature of the transactions they undertake. Rendering BSA compliance more challenging is the fact that such risks are constantly mutating, as criminal and terrorist elements alter their tactics to avoid detection. They move quickly from one base of operations to another, finding sanctuary in places where law enforcement, or sympathy for U.S. policy objectives, is weakest. Furthermore, money laundering and terrorist financing schemes are becoming more complex, involving entities and individuals located in numerous jurisdictions worldwide.

Comptroller Curry emphasized, and we reaffirm today, that notwithstanding these challenges, the OCC expects the institutions we supervise to have effective programs in place to comply fully with the requirements of the BSA. Primary responsibility for compliance with the BSA rests with the nation's financial institutions themselves. The OCC and the other Federal banking agencies are charged with ensuring that these institutions have effective systems and controls to detect and monitor for suspicious activity related to money laundering and terrorist financing, provide the necessary reports to law enforcement, and compile and maintain records that are useful to regulatory and criminal investigations. This is not a static area of compliance as new money laundering and terrorist financing risks emerge and as existing risks change. Therefore, the OCC remains committed to continually improving our supervisory processes to help ensure the ongoing effectiveness of national banks' and federal savings associations' (hereafter referred to as "banks") BSA compliance programs.

The Subcommittee's Report (Report) contains three recommendations focused on the OCC's BSA/AML supervision. We agree with the concerns reflected in each of the recommendations and will take actions in response. We have already identified a new approach that we will implement to assure that BSA/AML deficiencies are fully considered in a safety and soundness context and are taken into account as part of the "Management" component of a bank's CAMELS rating. We are revising and clarifying the operation of our cross-functional Large Bank BSA Review Team (LB Review Team) to enhance our ability to bring different perspectives to bear and react on a more timely basis to circumstances where a bank has multiple instances of Matters Requiring Attention, or apparent violations of the required components of its BSA/AML program. We will also explore how we track and review relevant information in this regard and whether new initiatives are appropriate in that area as well. We will also revisit our current approach to citing BSA/AML violations in order to provide more flexibility for individual "pillar" violations to be cited, and we will identify what steps we can take in our examinations to more promptly obtain a holistic view of a bank's BSA/AML compliance. Finally, we will review other areas, such as training, staffing, recruitment, policies, and interagency coordination, to make improvements in our BSA/AML supervision program.

## **II. OCC BSA/AML Supervisory Policies and Practice**

Recognizing the increasing and evolving challenges of BSA/AML compliance, the OCC has continually sought ways to enhance and improve our supervision. In 2005, we undertook a set of comprehensive initiatives to improve our BSA/AML supervision. These initiatives were designed to strengthen OCC BSA/AML examinations; enhance OCC resources and expertise devoted to BSA/AML supervision; and provide clear and consistent communications about our BSA/AML supervisory expectations to the industry. Some of the key changes in our BSA/AML



supervision included the development and implementation of enhanced risk identification and analysis tools, such as the OCC's Money Laundering Risk Assessment system (MLR), which enables the OCC to identify potentially high-risk banks and activities that warrant increased scrutiny and supervisory resources. With the other Federal banking agencies, we finalized and issued the Federal Financial Institutions Examination Council's (FFIEC) Interagency BSA/AML Examination Manual (Manual) that provides consistent and comprehensive examination procedures for BSA/AML and OFAC. We also worked with the other Federal banking agencies to develop and issue a uniform policy on citing BSA compliance program violations and taking enforcement actions. And we created and filled a new Director-level position for the OCC's BSA/AML Compliance Policy Department and augmented staff reporting to this new Director.

In addition to the development and annual maintenance of the MLR information collection system, the OCC implemented a number of quality assurance processes to ensure that we are consistent in identifying and communicating BSA issues. These initiatives include enhanced MRA tracking and the LB Review Team process. The LB Review Team was formed in 2004 to ensure consistency in the area of BSA/AML compliance for the largest banks under our supervision. The LB Review Team is comprised of the Director of the Enforcement and Compliance Division, the Director for BSA/AML Compliance Policy, and the Senior Counsel for BSA/AML.

The BSA/AML Compliance Policy Department provides comprehensive BSA training to our examiners and organizes a BSA compliance conference every three years to inform our examiners of emerging money laundering and terrorist financing threats and vulnerabilities. Representatives of the law enforcement community are regular participants in these conferences and training sessions, establishing an on-going dialogue with our examiners concerning criminal typologies, schemes and arrangements. Such exchanges allow our examiners to be continually aware of the risks facing the banks, including those risks discussed here today, to scope examinations accordingly, and to provide timely guidance to the industry in addressing those risks.

The BSA/AML Compliance Policy Department also leads the OCC's National Anti-Money Laundering Group (NAMLG), which is an internal task force that serves as the focal point for BSA/AML issues within the agency. The NAMLG facilitates intra-agency communication; promotes cooperation and information sharing with national and district office AML groups; identifies emerging risks, best practices and possible changes in anti-money laundering policies and procedures; discusses legislative proposals; and serves as a clearing house for ideas developed throughout the OCC. The NAMLG's resource sharing program initiative provides BSA policy expert resources to complex banks, higher risk banks, or examinations in need of specialized expertise. The resource sharing program promotes BSA/AML knowledge transfer, examiner development, and improves the allocation of BSA resources.

Globalization is a critical feature of the business activities of the large internationally-active banks. It provides them with access to new markets, customers and opportunities. However, it also increases their exposure to potential money laundering and terrorist financing risks. The OCC recognizes this challenge and the BSA/AML Compliance Policy Department works closely with the U.S. Treasury's Office of Terrorism and Financial Intelligence (TFI), FinCEN, and

OFAC to promote the implementation of sound international anti-money laundering and counter terrorist financing (AML/CFT) standards. The OCC also annually hosts two AML schools to train our foreign counterparts, and we are active participants in the U.S. delegation to the Financial Action Task (FATF) that is led by TFI.

The OCC also works with the other FFIEC agencies, FinCEN and OFAC to review and develop BSA examination and enforcement policies and procedures. The publication of the Manual in 2005 was an outstanding example of cooperation and coordination within the government, and between the government and the banking industry. The Manual reinforces the agencies' position that sound BSA/AML risk management enables a banking organization to identify BSA/AML risks and better direct its resources, with the ultimate goal of helping safeguard its operations from money laundering, terrorist financing, and other illicit activities. The Manual has been revised three times since its initial publication so that it remains current with the latest technological and payment system innovations and emerging threats and vulnerabilities.

In fact, at the initiative of the OCC, the latest version of the Manual in 2010 contained a new section on bulk cash repatriation that provides detailed guidance and examination procedures relating to this high risk product. Based upon our experience and expertise in the bulk cash and remote deposit capture (RDC) area, the OCC took the lead in drafting the bulk cash section of the Manual and the related examination procedures, and updating the section on RDC. The next round of revisions to the Manual, which will be chaired by the OCC, is currently in the planning stages and should be completed during the next year. We expect that the revised Manual will include expanded sections on new payment systems such as prepaid access, mobile banking, and emerging risks associated with new products, services and customers that the agencies have identified through our collective supervisory processes.

The OCC monitors compliance with the BSA and its implementing regulations by applying the examination procedures set forth in the Manual. These procedures are typically completed within each bank's examination cycle. Community banks are on either 12 or 18 month examination cycles, and large banks and midsize banks are on an annual examination cycle. These procedures are risk-based and direct examiners to focus examination resources on high-risk areas within banks and high-risk banks. During an examination, examiners use the procedures to assess the implementation and effectiveness of the bank's policies, procedures, systems, and controls. Every BSA/AML examination includes, at a minimum, a review of the bank's risk assessment and its BSA/AML compliance program (focusing on internal controls, training programs, independent testing and BSA officer independence and qualifications). We also assess the effectiveness of the bank's OFAC compliance program.

OCC examiners perform ongoing supervision and conduct targeted testing in areas that may present higher money laundering and terrorist financing risks. The Manual also includes supplemental procedures that cover specific BSA requirements (*e.g.*, currency transaction reporting, suspicious activity reporting, foreign correspondent bank, private banking, funds transfer recordkeeping) and specific examination procedures covering risks from products and services and persons and entities (*e.g.*, correspondent banking, private banking, trade finance, electronic banking, third-party payment processors, bulk shipments of currency, pouch activities, politically exposed persons, business entities). The OCC routinely downloads and analyzes BSA

data, currency transaction reports and suspicious activity reports to identify unique risks and augment our risk-based examination processes. This information permits examiners to scope and plan examinations appropriately to ensure that the bank's higher risk activities are evaluated. Such activities may be reflected in accounts associated with repetitive SAR filings, significant cash activity, or activity that is inconsistent with the type of business of the customer, and are examples of the types of accounts that would be selected for transaction testing and further examiner investigation. In cases where examiners identify areas of concern, deficiencies or violations, they typically expand the examination scope and perform transaction testing in targeted areas to ensure they identify and evaluate all pertinent issues. This combination of our ongoing supervision and targeted examinations allows us to conclude on the adequacy of a bank's BSA/AML compliance program.

Currently, the OCC takes the findings from its BSA/AML and OFAC compliance examinations into account in determining the bank's regulatory ratings in two ways: (i) compliance risk management (including BSA/AML) is a part of the Management component of the Uniform Financial Institutions Rating System (UFIRS), more commonly referred to as CAMELS (Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk); and (ii) BSA/AML is taken into account as part of the compliance rating under the Uniform Interagency Consumer Compliance Rating System. The OCC's approach of factoring BSA/AML and OFAC compliance into the Consumer Compliance rating differs from the approach of the other Federal banking agencies, which incorporates consideration of a bank's BSA/AML and OFAC compliance only in the Management component of a bank's CAMELS rating.<sup>1</sup>

We appreciate the concerns raised in the Subcommittee's Report about this approach and the need to ensure that deficiencies in BSA/AML compliance are considered in the context of safety and soundness and are taken into account in determining the Management component of the CAMELS rating. To address this concern, we are developing directions to our examiners to view serious deficiencies in a bank's BSA/AML compliance area, including program violations, as presumptively adversely affecting a bank's Management component rating. We will also

<sup>1</sup> In assigning this compliance rating, OCC examiners consider major BSA/AML and OFAC examination findings including, but not limited to:

- The current and historical adequacy of the bank's BSA/AML/OFAC compliance program;
- The significance, volume, and history of program deficiencies and violations and whether they were accompanied by aggravating factors, such as highly suspicious activity creating a significant potential for money laundering, potential terrorist financing, and a pattern of structuring to evade reporting requirements;
- Money laundering and terrorist financing risks posed by the bank's customers, products and activities;
- The adequacy of monitoring systems to detect and report suspicious activity;
- The adequacy of systems to detect and report monetary transactions that require the filing of Currency Transaction Reports;
- The adequacy of systems to comply with BSA recordkeeping requirements;
- Evidence of insider complicity; and
- The board of directors' and management's willingness and ability to administer an effective BSA/AML and OFAC compliance program.

The Office of Thrift Supervision, prior to its merger with the OCC, used the same approach as the OCC by factoring BSA/AML and OFAC compliance into the Consumer Compliance rating and incorporating them within the Management rating, as appropriate.

provide guidance on how to document application of this approach in determining the Management component rating.

### **III. OCC's BSA/AML Supervisory and Enforcement Process**

The OCC uses a variety of methods to communicate problems or weaknesses in a bank's systems and controls, including BSA deficiencies, and to obtain corrective action. In most cases, problems in the BSA/AML area, as well as in other areas, are corrected by bringing the problem to the attention of bank management and obtaining management's commitment to take corrective action promptly. The Report of Examination or, in the case of large or midsize banks, the Supervisory Letter, documents the OCC's findings and conclusions with respect to its supervisory review of a bank.

Problems or weaknesses are communicated to the bank's senior management and board of directors in the "Matters Requiring Attention" (MRA) section of the Report of Examination or Supervisory Letter. MRAs are conditions or issues that management is required to change or correct. MRAs are a serious consequence of the examination and they include practices that: (i) deviate from sound governance, internal control and risk management principles which may adversely impact the bank's earnings or capital, risk profile, or reputation if not addressed; or (ii) result in substantive noncompliance with laws and regulations, internal policies, controls or processes, OCC supervisory guidance, or supervisory conditions imposed in an interpretive letter or licensing approval. Once MRAs are identified and communicated to the bank, the bank's senior management and board of directors are required to promptly correct them within the agreed upon time frame. OCC examiner guidance specifically provides that supervisory strategies for banks with MRAs must include plans to follow up on the concerns. The plans need to be consistent with the seriousness of the MRA and include activities to monitor progress and verify the effectiveness of the corrective actions. The OCC does not deem an MRA corrected until the supervisory office has verified that the bank has adopted and implemented an effective corrective action.

MRAs involving banks in our Large Bank supervision program are tracked by the OCC in a Large Bank data system that is continually updated by the examiners. On a quarterly basis, Large Bank supervision reports on the outstanding MRAs by bank and core function to ensure that corrective actions remain on track.

When deficiencies in the BSA/AML area rise to the level of a BSA compliance program violation (12 C.F.R. § 21.21), or when a bank fails to correct problems with the program that had been previously reported to the bank (including through MRAs), a statutory mandate (12 U.S.C. 1818(s)) requires the banking agency to use its cease and desist (C&D) authority to correct the problem. Section 1818(s) specifically provides that if an insured depository institution has failed to establish and maintain a BSA compliance program or has failed to correct any problem with the BSA compliance program previously reported to the institution by the appropriate Federal banking agency, the agency shall issue a C&D order against the institution.

To ensure that the OCC's process for taking administrative enforcement actions based on BSA violations is measured, fair, and fully informed, in 2005, the OCC adopted a process for taking

administrative enforcement actions against banks based on BSA violations, including situations where a bank fails to correct a problem that was previously brought to its attention. This process includes the following stages:

- (i) Preliminary assessment of the facts and discussion with bank management.
- (ii) Additional reviews by cross functional review groups, including the OCC's LB Review Team.
- (iii) Written findings provided to the bank and an opportunity for the bank to respond.
- (iv) Washington Supervision Review Committee (WSRC) review. The WSRC reviews significant enforcement actions proposed to be taken by the OCC, including all cases involving BSA enforcement, all cases that are unique or highly visible, and those cases involving referrals to other agencies.
- (v) Final decision by the appropriate Senior Deputy Comptroller.

As previously noted, the OCC also worked within the FFIEC to develop and issue an interagency policy on citing BSA compliance program violations and taking enforcement actions, and our enforcement decisions are framed by that policy. The Interagency Statement on Enforcement of BSA/AML Requirements (Interagency Statement) was issued in 2007 and it sets forth the Federal banking agencies' policy on the circumstances in which an agency will issue a C&D order to address noncompliance with certain BSA/AML requirements, particularly in light of the statutory mandate in Section 1818(s). The Interagency Statement provides that a compliance program violation occurs where either of the following conditions exists:

The bank fails to adopt or implement a written BSA compliance program that adequately covers the required program elements: (1) internal controls (including customer due diligence, procedures for monitoring suspicious activity or appropriate risk assessment); (2) independent testing; (3) designated compliance personnel; and (4) training; or

The bank has defects in its BSA compliance program in one or more program elements indicating that either the written program or its implementation is not effective. For example, program deficiencies indicate ineffectiveness where the deficiencies are coupled with other aggravating factors such as evidence of: (i) highly suspicious activity creating a significant potential for unreported money laundering or terrorist financing; (ii) patterns of structuring to evade reporting requirements; (iii) significant insider complicity; or (iv) systemic failures to file currency transaction reports, suspicious activity reports, or other required BSA reports.

A program violation may occur where customer due diligence, monitoring of suspicious activity, risk assessment, or other internal controls fails with respect to a "high risk area," or to "multiple lines of business that significantly impact the institution's overall BSA compliance." An agency

will also consider the application of the institution's program across its business lines and activities. In the case of institutions with multiple lines of business, deficiencies affecting only some lines of business or activities would need to be evaluated to determine if the deficiencies are so severe or significant in scope as to result in a conclusion that the institution has not implemented an effective overall program.

The Interagency Statement also specifically addresses repeat problems for purposes of the statutory mandate for a C&D order in 12 U.S.C. § 1818(s). It provides that in order to be considered a "problem" within the meaning of section 1818(s), the deficiency reported to the institution would ordinarily involve a serious defect in one or more of the required components of the institution's BSA compliance program or implementation thereof. In addition, it sometimes takes a considerable period of time to correct BSA/AML deficiencies especially when large institutions merge system platforms and information technology changes are required. As a result, with regard to repeat problems, the Interagency Statement provides that a C&D is not required if the agency determines that the institution has made "acceptable substantial progress" toward correcting the problem at the time of the examination immediately following the examination where the problem was first identified and reported to the institution.

The Report highlights and calls for change in the OCC's current practice of not citing violations of the individual required components of an effective BSA program (*i.e.*, internal controls, independent testing, designated compliance personnel, and training) where the deficiencies fall short of a program violation. We understand the concerns reflected in the Report that the OCC's approach seems to limit examiners to using only MRAs to remedy identified problems, and we will revisit our current approach in order to provide more flexibility for individual "pillar" violations to be cited. One of the reasons for the current OCC approach is that it requires the OCC to focus on determining whether the deficiencies in a bank's program amount to a BSA compliance program violation. Therefore, in implementing changes on this point, it will be important not to create disincentives to making the tough calls when there are BSA compliance program violations mandating the issuance of a C&D order.

While our practice in this regard has differed from that of the other Federal banking agencies, the OCC's public enforcement record is nonetheless strong. As shown in Section IV below, between 2005 and 2011, the OCC issued BSA/AML focused C&Ds against banks at nearly twice the rate of the Federal Deposit Insurance Corporation (FDIC), the nearest other agency (per number of banks supervised), and issued CMPS at nearly four times the rate of the FDIC. The OCC also brought over 60 percent of the total dollar value of BSA penalty actions issued by the OCC, the Board of Governors of the Federal Reserve System (Federal Reserve) and the FDIC.<sup>2</sup> Thus, the component violations being cited by these other agencies are not resulting in as many C&D orders or CMP actions (which are the most stringent types of actions taken), as compared to the approach taken by the OCC.

<sup>2</sup> As set forth in the charts on the following page, between 2005 and 2011, the OCC brought 43 BSA/AML focused C&Ds against banks as compared to 58 for the FDIC and 9 for the Federal Reserve. In addition, the OCC issued CMPS against 14 banks totaling \$124 million, as compared to six CMPS issued by the FDIC totaling \$24.675 million, and two CMPS issued by the Federal Reserve totaling \$50 million. In 2011, the OCC supervised 1,973 banks, the FDIC supervised 4,647 banks, and the Federal Reserve supervised 826 banks and bank holding companies.

#### **IV. OCC BSA/AML Enforcement Actions and Industry Trends**

In recent years, the OCC has taken numerous formal actions against national banks to bring them into compliance with the BSA. These actions are typically C&D orders. The OCC has also taken formal actions against institution-affiliated parties who participated in BSA violations. Since September 11, 2001, the OCC has issued over 180 public formal enforcement actions based in whole, or in part, on BSA/AML violations (including formal agreements, C&D orders and civil money penalty (CMP) actions). As set forth in the following charts, between 2005 and 2011, the OCC brought BSA focused C&D orders and CMP actions against banks at a higher rate than the FDIC and the Federal Reserve (per number of banks supervised):

Number of Bank BSA Focused C&D Orders by Agency

	2005	2006	2007	2008	2009	2010	2011	Totals
OCC	16	10	2	4	0	9	2	43
FDIC	1	7	20	11	7	5	7	58
Federal Reserve	2	1	1	1	1	2	1	9

Number of Depository Institutions Regulated by Agency

	2005	2006	2007	2008	2009	2010	2011	
OCC	1984	1762	1662	1559	1495	1418	1973	
FDIC	-	5243	5200	5140	4987	4785	4647	
Federal Reserve	-	896	877	875	846	826	826	

Number of Bank BSA CMP Actions by Agency

	2005	2006	2007	2008	2009	2010	2011	Totals
OCC	3	1	3	2	1	2	2	14
FDIC	0	3	0	0	0	1	2	6
Federal Reserve	1	0	1	0	0	0	0	2

Dollar Amounts of Bank BSA CMP Actions by Agency (In Millions)

	2005	2006	2007	2008	2009	2010	2011	Totals
OCC	\$27.75	\$0.15	\$10.75	\$15.2	\$5.0	\$50.2	\$15.0	\$124.05
FDIC	0	\$13.4	0	0	0	\$0.25	\$11.25	\$24.675
Federal Reserve	\$30.0	0	\$20.0	0	0	0	0	\$50.00

Some of the more significant recent cases were actions against Wachovia Bank, N.A., Zions First National Bank, and Citibank, N.A. There are also many other examples where the OCC identified BSA non-compliance or, in some cases, actual money laundering, took effective action to stop the activity, and ensured that accurate and timely referrals were made to law enforcement. The Wachovia, Zions, and Citibank actions are discussed below:

Wachovia Bank, N.A., Charlotte, North Carolina (Wachovia) - On March 17, 2010, the OCC assessed a \$50 million penalty and issued a C&D order against this bank for violations of the BSA as part of a coordinated action with the Department of Justice, FinCEN, and other federal agencies. Wachovia also entered into a deferred prosecution agreement with the U.S. Attorney's Office in the Southern District of Florida and the Department of Justice (DOJ) Asset Forfeiture and Money Laundering Section (AFMLS) and agreed to forfeit \$110 million to the U.S. Additionally, FinCEN assessed a \$110 million civil money penalty that was deemed satisfied by the forfeiture to the U.S. Government.

The OCC found that Wachovia: (a) failed to implement adequate policies, procedures, or monitoring controls governing the repatriation of nearly \$14 billion of U.S. dollar (USD) bulk cash for high risk casa de cambio (CDC) and other foreign correspondent customers; (b) failed to conduct monitoring of high volumes of monetary instruments flowing through the CDCs and other foreign correspondent accounts in the form of RDC products, consisting of nearly six million checks worth approximately \$41 billion; (c) failed to conduct adequate levels of due diligence of high risk CDC and foreign correspondent customers; (d) failed to appropriately monitor traveler's checks in a manner that was consistent with the bank's policy limits over sequentially numbered traveler's checks for high risk CDC customers; (e) failed to appropriately institute risk-based monitoring of the bank's foreign correspondent customers, primarily as a result of placing too much emphasis on staffing considerations when setting alert parameters; (f) failed to file timely SARs involving suspicious transactions conducted through certain foreign correspondent accounts at the bank; and (g) failed to adequately report cash structuring activity from review of alerts generated in the bank's Financial Intelligence Unit. After conducting a voluntary look back, the bank filed over 4,300 SARs involving suspicious transactions conducted through the bank by CDCs and high risk foreign correspondent customers.

The OCC's enforcement action focused attention on the bulk cash repatriation money laundering scheme. The OCC played a lead role in this case and linked remote cash letter instrument processing to the bulk cash scheme. As a result of the Wachovia investigation and findings, the OCC took the lead in integrating bulk cash processing and the RDC implications into the Manual and commenced horizontal reviews of bulk cash activity and RDC at all national banks in the OCC's Large Bank supervision program, including HSBC's banknote activity.

Shortly after the Wachovia case, the government of Mexico implemented significant restrictions on U.S. dollar transactions at Mexican financial institutions and made significant changes to its AML laws and regulatory processes. In response, the drug cartels have adjusted their money laundering schemes and techniques to adapt to this change, and the OCC continues to work with law enforcement to identify new areas of vulnerability.

Zions First National Bank, Salt Lake City, Utah (Zions) - On February 11, 2011, the OCC assessed an \$8 million penalty against Zions for failures involving correspondent banking and RDC. Concurrent with the OCC's penalty, FinCEN assessed an \$8 million penalty against Zions. Both penalties were satisfied by a single \$8 million payment to the U.S. Department of the Treasury. The OCC had commenced an investigation into the bank's former foreign correspondent business and identified deficiencies in its BSA/AML controls, which resulted in



violations of law. In particular, the bank pioneered the development of a RDC product that enabled customers to deposit imaged items electronically from remote locations and marketed this product to high risk customers with insufficient regard for BSA/AML compliance implications. The bank exited the foreign correspondent line of business in early 2008, promptly conducted a voluntary look back, and reported suspicious activity. The significance of this case is that it presents a good example of how banks need to ensure that compliance issues are at the forefront of technological developments and are not secondary issues to be considered after the product is launched and the volumes become unmanageable.

*Citibank, N.A., Sioux Falls, South Dakota (Citibank)* - On April 4, 2012, the OCC entered into a consent order with Citibank, N.A., to address BSA deficiencies involving internal controls, customer due diligence, audit, monitoring of its RDC and international cash letter instrument processing in connection with foreign correspondent banking, and suspicious activity reporting relating to that monitoring. These findings resulted in violations by the bank of statutory and regulatory requirements to maintain an adequate BSA compliance program, file SARs, and conduct appropriate due diligence on foreign correspondent accounts. Among its requirements, the consent order directs the bank to: (i) ensure the independence of the bank's compliance staff, (ii) require new products and services be subject to high level compliance review, (iii) ensure that all customer due diligence processes are automated and accessible; and (iv) conduct a look back of the RDC cash letter activity.

Each of these cases has been discussed extensively at public forums and they underscore the OCC's commitment to ensuring that all national banks and federal savings associations have a strong BSA/AML function that keeps pace with changing technologies and threats.

Our examination and enforcement activities have identified a number of trends and concerns in the BSA/AML area that warrant continued attention by supervisors and banks:

- Compliance Resources – Some cases have identified the lack of sufficient staffing, high turnover rates, or the impact of compliance cuts on the program. In some cases, banks cut staffing and resources in the BSA area during the financial crisis. In other cases, banks' compliance department staff and expertise have failed to keep pace with the growth of the institution. For example, a mid-size bank should not have the same compliance program and staff levels that it had when it was a smaller community bank.
- International Focus or Component – Foreign correspondent banking, cross border funds transfers, bulk cash repatriation, remote deposit capture, and embassy banking have all been high risk areas that some banks have not managed effectively.
- New Technologies – Some banks have introduced new technologies and products without appreciating or understanding the compliance risks. In addition, some products have evolved through technology and need to be periodically re-evaluated (e.g., prepaid access money transfers, payroll cards).
- Third-Party Relationships and Payment Processors – The OCC and the other banking agencies have been reviewing closely third-party and payment processor relationships

and a number of enforcement actions have been taken in recent years. Banks need to be especially aware of the risks presented by payment processors and the extent of their franchising relationships (RTN numbers, routing numbers, and ATM machines).

- Evolving Payments Activities – Prepaid access, mobile phone banking, smart ATM machines and kiosks, mobile wallets, and Internet cloud-based payment processes are all technologies that are developing rapidly, and senior bank compliance personnel need to be engaged in the product development processes. OFAC monitoring is especially important and challenging in this area.
- Migration to Smaller Banks – As some large or mid-size banks have attempted to lower their risk profiles, money launderers have tried to enlist community banks to step in and provide key payments functions. This raises concern as these institutions may lack the resources and personnel necessary to successfully manage higher risk activities.

Many of the practical problems seen in recent years with respect to BSA compliance can be summed up within four areas: (i) culture of compliance within the organization, (ii) commitment of sufficient and expert resources, (iii) strength of information technology and monitoring processes, and (iv) sound risk management. The OCC will continue to identify these trends, communicate them to the industry, and ensure that BSA/AML supervision stays current.

#### **V. Improvements Undertaken to Improve BSA/AML Supervision**

The OCC is committed to rigorous supervision, strong enforcement, and continuous improvement to our supervisory approach to BSA/AML compliance. While we have previously discussed herein some recent BSA/AML related initiatives, other current initiatives include the following:

- We are implementing changes to our LB Review Team process to make it more effective in supporting and ensuring consistency of the supervisory processes for the larger banks we supervise.
- We are reviewing the manner in which MRAs are reported to ensure that banks with high numbers of MRAs in one particular CAMELS/ITCC area are receiving additional supervisory attention and, in the case of BSA/AML, consideration of formal enforcement action.
- The OCC's MLR database includes a detailed inventory of the products and services being offered by each community bank so that the OCC can assess the BSA/AML risks within each particular institution for use in scoping and staffing examinations. We will annually update the information collection processes pertaining to this tool to ensure that it captures higher risk and novel products. We will also consider whether similar tools should be implemented to our Large Bank and Midsize Bank portfolios.
- As previously described, we are strengthening and reinforcing the expectation that BSA/AML and OFAC deficiencies are taken into consideration in determining the

Management rating. We will also instruct our examiners to cease the practice of factoring BSA/AML and OFAC compliance into the Consumer Compliance rating.

- As described in Section III, we will also look closely at the Report's recommendation concerning citing BSA/AML compliance violations.

In addition, we are committed to keeping abreast of how new technologies and payment systems may affect BSA/AML compliance and to provide the industry and examiners with guidance on these emerging risks. For example, in 2006 the OCC issued comprehensive risk management guidance for Automated Clearing House (ACH) transactions, and the OCC continues to work with the other regulators to ensure that international ACH transactions are properly monitored for both BSA/AML and OFAC compliance. In June of last year, the OCC issued risk management guidance for prepaid access programs and continues to develop guidance for banks with regard to this rapidly growing product. And earlier this month, the OCC worked with the FFIEC to issue a statement on outsourced Internet cloud computing services that discusses key risk considerations associated with outsourced cloud computing activities, including cloud based payment processes and systems, and identifies applicable risk mitigation considerations contained in the various booklets that comprise the FFIEC IT Examination Handbook.

#### **VI. Overview of HSBC and OCC's BSA/AML Examinations**

HSBC North America Holdings Inc. (HNAH) is the holding company for HSBC's operations in the U.S. HNAH is controlled by HSBC plc, London, England (HSBC Group), a \$2.5 trillion global banking company with hundreds of financial institution subsidiaries throughout the world. The principal subsidiaries of HNAH at December 31, 2011 were HSBC USA Inc. (HUSI), HSBC Markets (USA) Inc, a holding company for certain global banking and markets subsidiaries, HSBC Finance Corporation, a holding company for consumer finance businesses, and HSBC Technology and Services (USA) Inc, a provider of information technology and centralized operational and support services among the subsidiaries of HNAH. The Bank is a subsidiary of HUSI. "Group Entities" are foreign affiliates of the Bank in which HSBC Group holds a majority interest.

The Bank serves 3.8 million customers through its personal financial services, commercial banking, private banking, asset management, and global banking and markets segments. It operates several hundred bank branches throughout the U.S., predominantly in New York State as well as branches and/or representative offices in California, Connecticut, Delaware, Florida, Georgia, Illinois, Maryland, Massachusetts, New Jersey, North Carolina, Oregon, Pennsylvania, Texas, Virginia, Washington, and the District of Columbia. The Bank has five main lines of business as follows:

- Retail Banking and Wealth Management provides a broad range of financial products and services including loans, residential mortgages, deposits, branch services and brokerage products and services;
- Commercial Banking offers global banking services, along with financial planning to companies, government entities and non-profit organizations. In addition to deposits,

services include payments and cash management (PCM), merchant services, trade, supply chain, receivables finance, corporate finance, global markets and risk advisory;

- (iii) Global Banking and Markets is an emerging markets-led and financing focused business that provides tailored financial solutions to government, corporate and institutional clients worldwide, and the Bank manages its Global Banking and Markets operations as a global business and maintains offices in more than 60 countries and territories;
- (iv) HSBC Global Asset Management is the core investment business of the HSBC Group managing assets totaling \$429.4 billion; and
- (v) HSBC Private Bank, a division of the Bank, offers wealth management and specialist advisory services for high net worth individuals and families with local and international needs.

On April 30, 2003, the then HSBC Bank USA entered into a written agreement with the Federal Reserve Bank of New York and the New York State Banking Department regarding its compliance with AML requirements. When HSBC Bank USA merged with HSBC Bank & Trust (Delaware) N.A., on July 1, 2004, the OCC, as the regulator of the surviving national bank, made the merger conditional on the Bank's continuing compliance with the requirements of the written agreement. On February 6, 2006, the OCC determined that the Bank had satisfied the requirements of the written agreement and the agreement was terminated.

Between 2004 and 2009, on-site OCC examiners conducted numerous examinations and issued Supervisory Letters covering, among other areas, pouch activity, embassy banking, foreign correspondent banking, PCM, SAR monitoring systems, and risk assessment processes and systems. During these examinations, the OCC followed the FFIEC Manual examination procedures and conducted transaction testing. Over the course of this five year period, the OCC issued Supervisory Letters that contained a significant number of MRAs that the Bank committed to resolving. The MRAs addressed BSA/AML risk assessments, customer due diligence, compliance leadership, staffing, alert backlogs, and SAR monitoring processes and enhancements.

As described earlier in this testimony, compliance with MRAs is tracked as part of the OCC's supervisory process. In this case, MRAs in the BSA/AML area were reviewed periodically, and determinations were made whether the MRAs had been addressed.

In mid-2009, as a result of the bulk cash findings in the Wachovia investigation, the OCC launched horizontal examinations of banknote operations in other large national banks supervised by the OCC that included HSBC and its transactions with HSBC Mexico. After finding significant deficiencies in the Bank's oversight of its banknote operations and after meeting with law enforcement and obtaining additional information on this activity, the OCC developed a detailed action plan to expand the scope of the ongoing examination of banknote customers. The expanded scope included evaluation of the Bank's compliance with all BSA/AML laws and regulations relating to foreign correspondent activity (including RDC

activity, pouch activity, and specific foreign correspondent relationships), OFAC compliance, and the effectiveness of management's efforts to manage risk on an enterprise wide basis.

The OCC conducted its expanded examination during 2009-10. It encompassed, among other things, an evaluation of specific banknote clientele. The OCC reviewed internal bank policies and procedures, systems and controls, training initiatives, and documentation supporting the Bank's compliance efforts. The examiners reviewed know-your-customer documentation/information pertaining to the sample, customer due diligence documentation/information, enhanced due diligence documentation/information, related account statements, specific transactions, pouch activities, cash letter activities, wire transfer activities, audit report/processes, RDC activity, foreign exchange transactions, trade transactions, monitoring processes, alert processing, SAR and related processes, subpoena documentation/information, the Bank's OFAC program, and all other relevant bank documentation and correspondence from 2004 to the current period.

As a part of the examination, the OCC notified the Bank in March 2010 that it had violated OCC regulations due to a significant backlog of unprocessed alerts. The Bank's subsequent review of the backlogged alerts led it to file a substantial number of late SARs with law enforcement authorities. The OCC also identified a number of previously undisclosed bearer share account relationships. The OCC is currently assessing the consequences of this finding, and the Bank's implementation of corrective measures.

The OCC ultimately determined that the Bank failed to adopt and implement a compliance program that adequately covered the required BSA/AML program elements including, in particular, internal controls for customer due diligence, procedures for monitoring suspicious activity, and independent testing. The Bank's compliance program and its implementation were found to be ineffective, and accompanied by aggravating factors, such as highly suspicious activity creating a significant potential for unreported money laundering or terrorist financing.

The number of MRAs cited over the preceding years reflected a pattern where the Bank reacted when problems were identified by the OCC, but failed to fulfill its fundamental responsibility of maintaining a program that effectively deterred money laundering and self-identifying and correcting deficiencies in its BSA/AML program. In addition, based on issues we had identified in our exams at other institutions, we began to drill down into specific areas of the Bank's operations. As we did so, we discovered that the Bank had additional and severe pre-existing BSA/AML deficiencies -- beyond what we had previously understood. Our work in these areas triggered further discoveries of additional, severe deficiencies. As a result, in the fall of 2010, we took forceful and comprehensive enforcement action. With the benefit of hindsight, the OCC should have taken this action sooner.

## **VII. HSBC C&D Order**

The OCC issued a C&D order against the Bank in October 2010. Concurrent with the OCC's enforcement action, the Federal Reserve issued a C&D order upon consent with the Bank's parent company, HNAH, to ensure the adequacy of the parent company's firm-wide compliance

risk management program. The OCC and the Federal Reserve coordinated closely in drafting the respective orders.

Some of the critical deficiencies in the Bank's BSA/AML compliance program cited in the OCC's order included the following:

- Lack of effective monitoring of wire activity. The Bank, in effect, exempted from automated monitoring wire transfers for customers domiciled in countries risk rated as standard or medium risk. This represented two-thirds of total dollar volume for PCM. While the Bank employed other methods for monitoring wire transactions for customers located in countries risk rated standard or medium, these alternatives provided limited coverage, were not effective, and did not mitigate the BSA/AML risks posed.
- From mid-2006 through mid-2009, the Bank did not perform any BSA/AML monitoring for banknote (or "bulk cash") transactions with Group Entities (affiliates).
- The Bank did not maintain customer due diligence information on Group Entities.
- The Bank failed to resolve its monitoring system alerts in a timely manner, leading to significant backlogs and late SAR filings.
- The Bank did not appropriately designate customers as high risk for purposes of BSA/AML monitoring, even where a customer's association with politically-exposed persons could harm the Bank's reputation.
- Serious weaknesses in Bank's systems and controls constituted violations of 12 C.F.R. 21.21 (program), 21.11 (SAR), and 31 CFR 103.176 (correspondent banking).

As the OCC's order set forth, the violations and failures were the result of a number of factors, including: (i) inadequate staffing and procedures in the alert investigations unit that resulted in a significant backlog of alerts; (ii) the closure of alerts based on ineffective review; (iii) inadequate monitoring of Group Entities' correspondent accounts for purpose and anticipated activity, anti-money laundering record, or consistency between actual and anticipated account activity; (iv) unwarranted reliance on Group Entities' following HSBC Group BSA/AML policies; (v) inadequate monitoring of funds transfers; (vi) inadequate procedures to ensure the timely reporting of suspicious activity; (vii) failure to adequately monitor Group Entities' banknote activity; (viii) inadequate monitoring of correspondent funds transfer activity; and (ix) inadequate collection and analysis of customer due diligence information, including inadequate monitoring of politically exposed persons.

The OCC's C&D order requires the Bank to submit a comprehensive BSA/AML action plan to achieve full compliance and ensure that the Bank has sufficient processes, personnel and control systems to implement and adhere to the order. It requires the Bank to hire a qualified permanent regional compliance officer and a qualified, permanent BSA officer. It further requires the Bank to improve its BSA/AML monitoring systems, including its funds transfer monitoring, and to develop and maintain a management information system (MIS) program that compiles customer

due diligence and enhanced due diligence (know your customer) information that includes the identification of "offshore" correspondent accounts and the identification of politically exposed persons. The order also contains restrictions on growth, new products, and high-risk lines of business, and it requires OCC approval to reenter the bulk cash repatriation business.

The C&D order additionally required the Bank to hire an independent consultant to conduct a comprehensive account/transaction activity review (Look Back). The purpose of the Look Back was to determine whether suspicious activity was timely identified by the Bank and to supplement the OCC's investigation of specific account relationships, transactions, and products and services that had been identified as potentially problematic. (Transaction reviews and look backs are routinely used by the OCC and the other Federal banking agencies to require banks to review past activities and file SARs as necessary.) Some of the account relationships, transactions, and products and services included in the Subcommittee's report, were specifically covered within the scope of the Look Back.

The Look Back required the Bank to review 31 specific correspondent account relationships, including several HSBC affiliates and HSBC Mexico, over an eighteen month time period covering banknotes, wire, RDC, and pouch activities.

The Look Back also required the Bank to review specific alerts that had been closed due to a reduction in a country's risk rating and over a two month time period, including:

- All alerts closed based on "positive internet information;"
- Wire transfers originating in five standard and medium risk countries that were sent to seven high risk countries;
- Wire transfers (originating or terminating) between several pairs of standard and medium risk countries;
- International (cross-border) book entry transfers;
- All account activity during this period for accounts subject at any time during the period to requests pursuant to section 314(a) or section 314(b) of the USA PATRIOT Act, or to subpoenas relating to BSA/AML issues; and
- All alerts closed more than 60 days after generation of the alert including, without limitation, alerts closed in response to the OCC's Supervisory Letter (over a three month time period).

The C&D order is a remedial document that is designed to obtain correction of violations of law and unsafe or unsound practices at the Bank. The issuance of the order does not preclude the OCC from assessing a civil money penalty at a later time. The OCC is now actively engaged in evaluating the Bank's compliance with the C&D order and in considering the assessment of CMPs.

#### **VIII. Cooperation with Law Enforcement/Regulatory Agencies**

The OCC cooperates and coordinates on an interagency basis to address BSA/AML issues. We actively participate in several interagency groups focusing on BSA/AML compliance, including the Bank Secrecy Act Advisory Group (BSAAG), chaired by FinCEN, which is composed of policy, legal, and operations representatives from the major federal and state law enforcement and regulatory agencies involved in the fight against money laundering, as well as industry representatives; the FFIEC BSA Working Group which, similar to the FFIEC itself, has a rotating chairman and is composed of representatives of federal and state regulatory agencies; and the National Interagency Bank Fraud Working Group, chaired by the Department of Justice, and composed of representatives of the federal law enforcement and regulatory agencies (the OCC has been an active member of this group since its founding in 1984).

To remain in the forefront of new technologies and payment systems, the OCC also participates in various interagency working groups, including the Interagency Cyberfraud Working Group, the Payments Fraud Working Group, the Financial Services Information Sharing and Analysis Center (FS-ISAC), the BSAAG Prepaid Card Subcommittee, and regularly participates in payments conferences and industry forums.

In addition, the OCC works on an international basis with the Financial Action Task Force, an inter-governmental body whose purpose is the development and promotion of policies to combat money laundering. We have participated in various State and Treasury Department missions to assist foreign governments in their anti-money laundering efforts. We expect that these international efforts will continue. The OCC also regularly provides information, documents, and expertise to law enforcement for use in criminal investigations on a case-specific basis.

With respect to HSBC, the OCC has worked closely with the Federal Reserve, FinCEN and law enforcement in addressing the problems identified at HSBC and will continue to do so to ensure that all problems are identified and addressed.

#### **IX. Conclusion**

The OCC is committed to rigorous BSA/AML and OFAC supervision, strong enforcement, and continuing improvement in our supervision in this important area. We are closely reviewing the Subcommittee's Report and, as discussed earlier in this statement, we have already identified actions that we will take in response to its recommendations.

The OCC will continue to work with Congress, the other financial institutions regulatory agencies, law enforcement agencies, and the banking industry to develop and implement a coordinated and comprehensive response to the threat posed to the nation's financial system by money launderers, terrorist financiers and criminal organizations. The OCC recognizes that the determination and ingenuity of those who commit financial crimes requires ongoing vigilance. We also recognize that technical innovations, new and more convenient financial services products, and globalization trends are rapidly changing the BSA/AML landscape. These are major challenges for both the financial services industry and its regulators and, for our part, we are committed to meeting them.



*United States Senate*

**PERMANENT SUBCOMMITTEE ON INVESTIGATIONS**

*Committee on Homeland Security and Governmental Affairs*

*Carl Levin, Chairman*

*Tom Coburn, Ranking Minority Member*

**U.S. Vulnerabilities to Money Laundering,  
Drugs, and Terrorist Financing:  
HSBC Case History**

**MAJORITY AND MINORITY  
STAFF REPORT**

**PERMANENT SUBCOMMITTEE  
ON INVESTIGATIONS**

**UNITED STATES SENATE**



**RELEASED IN CONJUNCTION WITH THE  
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JULY 17, 2012 HEARING**

**SENATOR CARL LEVIN**  
Chairman

**SENATOR TOM COBURN, M.D.**  
Ranking Minority Member

**PERMANENT SUBCOMMITTEE ON INVESTIGATIONS**

**ELISE J. BEAN**  
Staff Director and Chief Counsel

**ROBERT L. ROACH**  
Counsel and Chief Investigator

**LAURA E. STUBER**  
Senior Counsel

**ALLISON ABRAMS**  
Detailee

**ERIC WALKER**  
Detailee

**KRISTIN GWIN**  
Congressional Fellow

**BRIAN EGGER**  
Detailee

**ADAM C. HENDERSON**  
Professional Staff Member

**CHRISTOPHER J. BARKLEY**  
Staff Director to the Minority

**KEITH B. ASHDOWN**  
Chief Investigator to the Minority

**JUSTIN J. ROOD**  
Senior Investigator to the Minority

**JAMIE BENCE**  
Law Clerk

**BILL GAERTNER**  
Law Clerk

**CURTIS KOWALK**  
Law Clerk

**KATIE MARTIN-  
BROWNE**  
Law Clerk

**WELLESLEY BAUN**  
Law Clerk

**LAUREN ROBERTS**  
Law Clerk

**MICHAEL WOLF**  
Law Clerk

**ARIELLE WORONOFF**  
Law Clerk

**TAMIR HADDAD**  
Intern

**SOFIA KNUTSSON**  
Intern

**NOELIA ORTIZ**  
Intern

**JASWANT SINGH**  
Intern

**MARY D. ROBERTSON**  
Chief Clerk

10/26/12

---

***Permanent Subcommittee on Investigations***  
199 Russell Senate Office Building - Washington, D.C. 20510  
Majority: 202/224-9505 - Minority: 202/224-3721  
Web Address: <http://www.hsgac.senate.gov/subcommittees/investigations>

**U.S. Vulnerabilities to Money Laundering, Drugs,  
and Terrorist Financing: HSBC Case History**

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**U.S. VULNERABILITIES TO MONEY LAUNDERING,  
DRUGS, AND TERRORIST FINANCING:  
HSBC CASE HISTORY**

This Report examines the anti-money laundering (AML) and terrorist financing vulnerabilities created when a global bank uses its U.S. affiliate to provide U.S. dollars, U.S. dollar services, and access to the U.S. financial system to high risk affiliates, high risk correspondent banks, and high risk clients. This Report also offers recommendations to strengthen correspondent AML controls to combat money laundering, drug trafficking, and terrorist financing.

**I. EXECUTIVE SUMMARY**

Over the last decade, the U.S. Senate Permanent Subcommittee on Investigations has worked to strengthen U.S. AML efforts by investigating how money launderers, terrorists, organized crime, corrupt officials, tax evaders, and other wrongdoers have utilized U.S. financial institutions to conceal, transfer, and spend suspect funds.<sup>1</sup> In 2001, the Subcommittee focused, in particular, on how U.S. banks, through the correspondent services they provide to foreign financial institutions, had become conduits for illegal proceeds associated with organized crime, drug trafficking, and financial fraud.<sup>2</sup> Correspondent banking occurs when one financial institution provides services to another financial institution to move funds, exchange currencies, cash monetary instruments, or carry out other financial transactions. The Subcommittee's 2001 investigation showed not only how some poorly managed or corrupt foreign banks used U.S. bank accounts to aid and abet, commit, or allow clients to commit wrongdoing, but also how U.S. financial institutions could protect themselves and the U.S. financial system from misuse.

In response to that investigation and the money laundering vulnerabilities exposed by the 9/11 terrorist attack, Congress enacted stronger AML laws as part of the Patriot Act of 2002, including stronger

<sup>1</sup> See, e.g., U.S. Senate Permanent Subcommittee on Investigations, "Keeping Foreign Corruption out of the United States," S.Hrg. 111-540 (Feb. 4, 2010); "Tax Haven Banks and U.S. Tax Compliance," S.Hrg. 110-614 (July 17 and 25, 2008); "Tax Haven Abuses: The Enablers, The Tools and Secrecy," S.Hrg. 109-797 (Aug. 1, 2006); "Money Laundering and Foreign Corruption: Enforcement and Effectiveness of the Patriot Act," S.Hrg. 108-633 (July 15, 2004); "Role of U.S. Correspondent Banking in International Money Laundering," S.Hrg. 107-84 (March 1, 2 and 6, 2001); and "Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerabilities," S.Hrg. 106-428 (Nov. 9 and 10, 1999). See also U.S. Senate Committee on Homeland Security and Governmental Affairs, "State Business Incorporation – 2009," S.Hrg. 111-953 (June 18 and Nov. 5, 2009).

<sup>2</sup> "Role of U.S. Correspondent Banking in International Money Laundering," U.S. Senate Permanent Subcommittee on Investigations, S.Hrg. 107-84 (March 1, 2 and 6, 2001)(hereinafter "2001 Subcommittee Hearing on Correspondent Banking"), at 1.

provisions to combat the misuse of correspondent services.<sup>3</sup> Federal bank regulators followed with stronger regulations<sup>4</sup> and examination requirements<sup>5</sup> to guard against money laundering through correspondent accounts. In response, over the next ten years, U.S. banks substantially strengthened their correspondent AML controls. Before the 2002 Patriot Act, for example, most U.S. banks opened correspondent accounts for any foreign bank with a banking license; now, most U.S. banks evaluate the riskiness of each foreign bank's owners, business lines, products, clients, and AML controls before agreeing to open an account. They also routinely monitor account activity and wire transfers for suspicious activity, with enhanced monitoring of high risk correspondents. In addition, before the 2002 Patriot Act, some U.S. banks readily opened accounts for foreign shell banks, meaning banks without any physical presence in any jurisdiction; today, in accordance with the Patriot Act's ban on shell bank accounts, all U.S. banks take measures to ensure they don't provide services to such banks, the ban on shell bank accounts has become an international AML standard,<sup>6</sup> and the thousands of stand-alone shell banks licensed by the Bahamas, Cayman Islands, Nauru, and other jurisdictions have virtually disappeared.

At the same time, the money laundering risks associated with correspondent banking have not been eliminated. Correspondent accounts continue to provide a gateway into the U.S. financial system, and wrongdoers continue to abuse that entryway. This investigation takes a fresh look at the U.S. vulnerabilities to money laundering and terrorist financing associated with correspondent banking, focusing in particular on the operations of global banks with U.S. affiliates that enable foreign financial institutions to gain access to the U.S. financial system.

**HSBC Case Study.** To examine the current money laundering and terrorist financing threats associated with correspondent banking, the Subcommittee selected HSBC as a case study. HSBC is one of the largest financial institutions in the world, with over \$2.5 trillion in assets, 89 million customers, 300,000 employees, and 2011 profits of nearly \$22 billion. HSBC, whose initials originally stood for Hong

<sup>3</sup> See, e.g., Sections 312, 313, and 319(b) of the USA Patriot Act (requiring due diligence to be conducted when opening accounts for foreign banks, with enhanced due diligence for offshore banks and banks in high risk jurisdictions; prohibiting the opening of correspondent accounts for shell banks; and strengthening the ability of U.S. regulators to obtain correspondent account records).

<sup>4</sup> See, e.g., 31 CFR §§103.175, 103.176, 103.177, 103.185.

<sup>5</sup> See, e.g., 4/29/2010 "Bank Secrecy Act/Anti-Money Laundering Examination Manual," issued by the Federal Financial Institutions Examination Council, "Foreign Correspondent Account Recordkeeping and Due Diligence," at 117-129, 183-187, [http://www.ffiec.gov/bsa\\_aml\\_infobase/documents/BSA\\_AML\\_Man\\_2010.pdf](http://www.ffiec.gov/bsa_aml_infobase/documents/BSA_AML_Man_2010.pdf). Prior versions of this Manual were issued in 2005 and 2007.

<sup>6</sup> See "International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations," issued by the Financial Action Task Force (2/2012), FATF Recommendation 13.



Kong Shanghai Banking Corporation, now has operations in over 80 countries, with hundreds of affiliates spanning the globe. Its parent corporation, HSBC Holdings plc, called "HSBC Group," is headquartered in London, and its Chief Executive Officer is located in Hong Kong.

Its key U.S. affiliate is HSBC Bank USA N.A. (HBUS). HBUS operates more than 470 bank branches throughout the United States, manages assets totaling about \$200 billion, and serves around 3.8 million customers. It holds a national bank charter, and its primary regulator is the U.S. Office of the Comptroller of the Currency (OCC), which is part of the U.S. Treasury Department. HBUS is headquartered in McLean, Virginia, but has its principal office in New York City. HSBC acquired its U.S. presence by purchasing several U.S. financial institutions, including Marine Midland Bank and Republic National Bank of New York.

A senior HSBC executive told the Subcommittee that HSBC acquired its U.S. affiliate, not just to compete with other U.S. banks for U.S. clients, but primarily to provide a U.S. platform to its non-U.S. clients and to use its U.S. platform as a selling point to attract still more non-U.S. clients. HSBC operates in many jurisdictions with weak AML controls, high risk clients, and high risk financial activities including in Asia, the Middle East, and Africa. Over the past ten years, HSBC has also acquired affiliates throughout Latin America. In many of these countries, the HSBC affiliate provides correspondent accounts to foreign financial institutions that, among other services, are interested in acquiring access to U.S. dollar wire transfers, foreign exchange, and other services. As a consequence, HSBC's U.S. affiliate, HBUS, is required to interact with other HSBC affiliates and foreign financial institutions that face substantial AML challenges, often operate under weaker AML requirements, and may not be as familiar with, or respectful of, the tighter AML controls in the United States. HBUS' correspondent services, thus, provide policymakers with a window into the vast array of money laundering and terrorist financing risks confronting the U.S. affiliates of global banks.

The Subcommittee also examined HSBC because of its weak AML program. In September 2010, the OCC issued a lengthy Supervisory Letter citing HBUS for violating Federal AML laws, including by maintaining an inadequate AML program. In October 2010, the OCC issued a Cease and Desist Order requiring HSBC to strengthen multiple aspects of its AML program.<sup>7</sup> The identified problems included a once massive backlog of over 17,000 alerts identifying possible suspicious

<sup>7</sup> On the same day, in coordination with the OCC, the Federal Reserve issued a Cease and Desist order to HBUS' holding company, HSBC North America Holdings, Inc. (HNAH), citing HNAH for an inadequate AML program and requiring it to revamp and strengthen both its program and that of HBUS.

activity that had yet to be reviewed; ineffective methods for identifying suspicious activity; a failure to file timely Suspicious Activity Reports with U.S. law enforcement; a failure to conduct any due diligence to assess the risks of HSBC affiliates before opening correspondent accounts for them; a 3-year failure by HBUS, from mid-2006 to mid-2009, to conduct any AML monitoring of \$15 billion in bulk cash transactions with those same HSBC affiliates, despite the risks associated with large cash transactions; poor procedures for assigning country and client risk ratings; a failure to monitor \$60 trillion in annual wire transfer activity by customers domiciled in countries rated by HBUS as lower risk; inadequate and unqualified AML staffing; inadequate AML resources; and AML leadership problems. Since many of these criticisms targeted severe, widespread, and longstanding AML deficiencies, they also raised questions about how the problems had been allowed to accumulate and why the OCC had not compelled corrective action earlier.

During the course of its investigation into HSBC's AML deficiencies, the Subcommittee issued multiple subpoenas and collected and reviewed over 1.4 million documents, including bank records, correspondence, emails, and legal pleadings. The Subcommittee staff also conducted over 75 interviews with officials at HSBC Group, HBUS, and other HSBC affiliates, as well as with U.S. banking regulators. In addition, the Subcommittee received numerous briefings from HSBC legal counsel, initiated inquiries with foreign banks that had HSBC accounts, and consulted with experts on AML and terrorist financing issues. HSBC was fully cooperative with the inquiry, producing documentation and witnesses from around the world, including documents for which it could have claimed privilege.

As a result of its investigation, the Subcommittee has focused on five issues illustrating key AML and terrorist financing problems that continue to impact correspondent banking in the United States. They include opening U.S. correspondent accounts for high risk affiliates without conducting due diligence; facilitating transactions that hinder U.S. efforts to stop terrorists, drug traffickers, rogue jurisdictions, and other from using the U.S. financial system; providing U.S. correspondent services to banks with links to terrorism; clearing bulk U.S. dollar travelers cheques despite signs of suspicious activity; and offering high risk bearer share corporate accounts. Avoiding the money laundering risks involved in these activities requires an effective AML program, with written standards, knowledgeable and adequate staff, the infrastructure needed to monitor account and wire transfer activity for suspicious transactions, effective AML training, and a compliance culture that values obtaining accurate client information. In addition to focusing on these five issues at HBUS, the Subcommittee investigation

examined the regulatory failures that allowed these and other AML problems to fester for years.

**Servicing A High Risk Affiliate.** In 2001, the Subcommittee's investigation debunked the notion that U.S. banks should open a correspondent account for any foreign bank with a banking license, establishing instead the need to use due diligence to evaluate the money laundering and terrorist financing risks posed by a specific foreign financial institution before opening an account. Today, some U.S. affiliates of global banks engage in an equally ill-advised practice, opening correspondent accounts for any affiliate owned by the parent holding corporation, with no analysis of the AML or terrorist financing risks.

Until recently, HSBC Group policy instructed its affiliates to assume that all HSBC affiliates met the Group's AML standards and to open correspondent accounts for those affiliates without additional due diligence. For years, HBUS followed that policy, opening U.S. correspondent accounts for HSBC affiliates without conducting any AML due diligence. Those affiliates have since become major clients of the bank. In 2009, for example, HBUS determined that "HSBC Group affiliates clear[ed] virtually all USD [U.S. dollar] payments through accounts held at HBUS, representing 63% of all USD payments processed by HBUS."<sup>8</sup> HBUS failed to conduct due diligence on HSBC affiliates despite a U.S. law that has required all U.S. banks, since 2002, to conduct these due diligence reviews before opening a U.S. correspondent account for any foreign financial institution, with no exception made for foreign affiliates.

One HSBC affiliate that illustrates the AML problems is HSBC Mexico, known as HBMX. HBUS should have, but did not, treat HBMX as a high risk correspondent client subject to enhanced due diligence and monitoring. HBMX operated in Mexico, a country under siege from drug crime, violence and money laundering; it had high risk clients, such as Mexican casas de cambio and U.S. money service businesses; and it offered high risk products, such as U.S. dollar accounts in the Cayman Islands. In addition, from 2007 through 2008, HBMX was the single largest exporter of U.S. dollars to HBUS, shipping \$7 billion in cash to HBUS over two years, outstripping larger Mexican banks and other HSBC affiliates. Mexican and U.S. authorities expressed repeated concern that HBMX's bulk cash shipments could reach that volume only if they included illegal drug proceeds. The concern was that drug traffickers unable to deposit large amounts of cash in U.S. banks due to AML controls were transporting U.S. dollars to Mexico, arranging for bulk deposits there, and then using Mexican

<sup>8</sup> See 9/9/2009 chart entitled, "HSBC Profile," included in "HSBC OFAC Compliance Program," a presentation prepared by HSBC and provided to the OCC, at HSBC OCC 8874197.

financial institutions to insert the cash back into the U.S. financial system.

In addition to its high risk location, clients, and activities, HMBX had a history of severe AML deficiencies. Its AML problems included a widespread lack of Know Your Customer (KYC) information in client files; a dysfunctional monitoring system; bankers who resisted closing accounts despite evidence of suspicious activity; high profile clients involved in drug trafficking; millions of dollars in suspicious bulk travelers cheque transactions; inadequate staffing and resources; and a huge backlog of accounts marked for closure due to suspicious activity, but whose closures were delayed. For eight years, from 2002 to 2010, HSBC Group oversaw efforts to correct HMBX's AML deficiencies, while those efforts fell short. At the same time, HSBC Group watched HMBX utilize its U.S. correspondent account, without alerting HBUS to the AML risks it was incurring.

HBUS compounded the AML risks it incurred from HMBX through its own AML deficiencies, which included failing to investigate or evaluate HMBX's AML risks. HBUS also failed, from mid-2006 to mid-2009, to conduct any AML monitoring of its U.S. dollar transactions with HSBC affiliates, including HMBX, despite the obvious well-known risks attendant with large cash transactions. In addition, because HBUS deemed HMBX to be located in a low risk country, HBUS failed until 2009, to monitor HMBX's wire transfer or account activity. HMBX illustrates the money laundering and drug trafficking risks that result when the U.S. affiliate of a global bank serves as the U.S. gateway for a high risk affiliate allowed to operate with no initial due diligence or ongoing monitoring.

**Circumventing OFAC Prohibitions.** The United States has devoted significant resources to stopping some of the most dangerous persons and jurisdictions threatening the world today from utilizing the U.S. financial system, including terrorists, persons involved with weapons of mass destruction, drug traffickers, and persons associated with rogue jurisdictions such as Iran, North Korea, and Sudan. To implement the law, the U.S. Treasury Department's Office of Foreign Assets Control (OFAC) has developed a list of prohibited persons and countries which banks use to create an "OFAC filter" to identify and halt potentially prohibited transactions. Transactions stopped by this filter typically undergo an individualized review to see if the transaction can proceed or the funds must be blocked.

Because the OFAC filter can end up delaying or blocking transactions that are permitted under U.S. law or by other jurisdictions, some non-U.S. financial institutions have used tactics to circumvent it. Common tactics include stripping information from wire transfer

documentation to conceal the participation of a prohibited person or country, or characterizing a transaction as a transfer between banks in approved jurisdictions, while omitting underlying payment details that would disclose participation of a prohibited originator or beneficiary. In the case of Iran, some foreign banks also abused what were known as "U-turn" transactions, which were allowable transactions under Treasury regulations prior to November 2008. In recent years, the United States has imposed steep penalties on banks that violated the OFAC prohibitions.

At HBUS, documents provided to the Subcommittee indicate that, for years, some HSBC affiliates took action to circumvent the OFAC filter when sending OFAC sensitive transactions through their U.S. dollar correspondent accounts at HBUS. From at least 2001 to 2007, two HSBC affiliates, HSBC Europe (HBEU) and HSBC Middle East (HBME), repeatedly sent U-turn transactions through HBUS without disclosing links to Iran, even though they knew HBUS required full transparency to process U-turns. To avoid triggering the OFAC filter and an individualized review by HBUS, HBEU systematically altered transaction information to strip out any reference to Iran and characterized the transfers as between banks in approved jurisdictions. The affiliates' use of these practices, which even some within the bank viewed as deceptive, was repeatedly brought to the attention of HSBC Group Compliance, by HBUS compliance personnel and by HBEU personnel who objected to participating in the document alteration and twice announced deadlines to end the activity. Despite this information, HSBC Group Compliance did not take decisive action to stop the conduct or inform HBUS about the extent of the activity. At the same time, while some at HBUS claimed not to have known they were processing undisclosed Iranian transactions from HSBC affiliates, internal documents show key senior HBUS officials were informed as early as 2001. In addition, HBUS OFAC filter repeatedly stopped Iranian transactions that should have been disclosed to HBUS by HSBC affiliates, but were not. Despite evidence of what was taking place, HBUS failed to get a full accounting of what its affiliates were doing or ensure all Iranian transactions sent by HSBC affiliates were stopped by the OFAC filter and reviewed to ensure they were OFAC compliant. In addition, documents show that, from 2002 to 2007, some HSBC affiliates sent potentially prohibited transactions through HBUS involving Burma, Cuba, North Korea, Sudan, and other prohibited countries or persons. Other documents indicate that some HSBC affiliates may have sent non-U.S. dollar messaging traffic through U.S. servers in which the OFAC filter was not turned on or was restricted.

An outside auditor hired by HBUS has so far identified, from 2001 to 2007, more than 28,000 undisclosed, OFAC sensitive transactions that were sent through HBUS involving \$19.7 billion. Of those 28,000

transactions, nearly 25,000 involved Iran, while 3,000 involved other prohibited countries or persons. The review has characterized nearly 2,600 of those transactions, including 79 involving Iran, and with total assets of more than \$367 million, as 'Transactions of Interest' requiring additional analysis to determine whether violations of U.S. law occurred. While the aim in many of those cases may have been to avoid the delays associated with the OFAC filter and individualized reviews, rather than to facilitate prohibited transactions, actions taken by HSBC affiliates to circumvent OFAC safeguards may have facilitated transactions on behalf of terrorists, drug traffickers, or other wrongdoers. While HBUS insisted, when asked, that HSBC affiliates provide fully transparent transaction information, when it obtained evidence that some affiliates were acting to circumvent the OFAC filter, HBUS failed to take decisive action to confront those affiliates and put an end to the conduct. HBUS' experience demonstrates the strong measures that the U.S. affiliate of a global bank must take to prevent affiliates from circumventing OFAC prohibitions.

**Disregarding Links to Terrorism.** For decades, HSBC has been one of the most active global banks in the Middle East, Asia, and Africa, despite being aware of the terrorist financing risks in those regions. In particular, HSBC has been active in Saudi Arabia, conducting substantial banking activities through affiliates as well as doing business with Saudi Arabia's largest private financial institution, Al Rajhi Bank. After the 9/11 terrorist attack in 2001, evidence began to emerge that Al Rajhi Bank and some of its owners had links to financing organizations associated with terrorism, including evidence that the bank's key founder was an early financial benefactor of al Qaeda. In 2005, HSBC announced internally that its affiliates should sever ties with Al Rajhi Bank, but then reversed itself four months later, leaving the decision up to each affiliate. HSBC Middle East, among other HSBC affiliates, continued to do business with the bank.

Due to terrorist financing concerns, HBUS closed the correspondent banking and banknotes accounts it had provided to Al Rajhi Bank. For nearly two years, HBUS Compliance personnel resisted pressure from HSBC personnel in the Middle East and United States to resume business ties with Al Rajhi Bank. In December 2006, however, after Al Rajhi Bank threatened to pull all of its business from HSBC unless it regained access to HBUS' U.S. banknotes program, HBUS agreed to resume supplying Al Rajhi Bank with shipments of U.S. dollars. Despite ongoing troubling information, HBUS provided nearly \$1 billion in U.S. dollars to Al Rajhi Bank until 2010, when HSBC decided, on a global basis, to exit the U.S. banknotes business. HBUS also supplied U.S. dollars to two other banks, Islami Bank Bangladesh

Ltd. and Social Islami Bank, despite evidence of links to terrorist financing. Each of these specific cases shows how a global bank can pressure its U.S. affiliate to provide banks in countries at high risk of terrorist financing with access to U.S. dollars and the U.S. financial system.

**Clearing Suspicious Bulk Travelers Cheques.** Another AML issue involves HBUS' clearing more than \$290 million in bulk U.S. dollar travelers checks in less than four years for a Japanese regional bank, Hokuriku Bank, despite evidence of suspicious activity. From at least 2005 to 2008, HBUS cleared bulk travelers cheques for Hokuriku Bank on a daily basis, at times clearing \$500,000 or more in U.S. dollars per day. The cheques were in denominations of \$500 or \$1,000, submitted in large blocks of sequentially numbered cheques, and signed and countersigned with the same illegible signature. An OCC examination which determined that HBUS was clearing travelers cheques with inadequate AML controls, discovered the stacks of Hokuriku travelers cheques being processed on a daily basis, and directed HBUS to investigate. When HBUS sought more information, Hokuriku Bank at first delayed responding, then provided minimal information, and finally declined to investigate further, claiming to be constrained by bank secrecy laws from disclosing client-specific information. HBUS eventually learned that the travelers cheques were purchased by Russians from a bank in Russia, a country at high risk of money laundering. HBUS also learned that the Japanese bank had little KYC information or understanding why up to \$500,000 or more in bulk U.S. dollar travelers cheques purchased in Russia were being deposited on a daily basis into one of 30 different Japanese accounts of persons and corporations supposedly in the used car business.

In October 2008, under pressure from the OCC, HBUS stopped processing the travelers cheques, but continued the correspondent relationship, despite the Japanese bank's poor AML controls. Two years later, in 2010, an OCC examination uncovered the ongoing relationship between HSBC and Hokuriku, which the OCC thought had ended. In 2012, after the Subcommittee inquired about the account, HBUS closed it. Since travelers cheques have been misused by terrorists, drug traffickers, and other criminals, the HBUS experience shows how a U.S. affiliate with ineffective AML controls can end up clearing suspicious bulk travelers cheques and facilitating the movement of hundreds of millions of U.S. dollars across international lines to unknown recipients.

**Offering Bearer Share Accounts.** Over the course of a decade, HBUS opened over 2,000 accounts in the name of bearer share corporations, a notorious type of corporation that invites secrecy and wrongdoing by assigning ownership to whomever has physical possession of the shares. At its peak, HBUS' Miami office had over

1,670 bearer share accounts; the New York office had over 850; and the Los Angeles office had over 30. The Miami bearer share accounts alone held assets totaling an estimated \$2.6 billion, and generated annual bank revenues of \$26 million. Multiple internal audits and regulatory examinations criticized the accounts as high risk and advocated that HBUS either take physical custody of the shares or require the corporations to register the shares in the names of the shareholders, but HBUS bankers initially resisted tightening AML controls, and regulators took no enforcement action.

Two examples of the accounts illustrate the risks they posed. In the first, Miami Beach hotel developers, Mauricio Cohen Assor and Leon Cohen Levy, father and son, used bearer share accounts they opened for Blue Ocean Finance Ltd. and Whitebury Shipping Time-Sharing Ltd. to help hide \$150 million in assets and \$49 million in income. In 2010, both were convicted of criminal tax fraud and filing false tax returns, sentenced to ten years in prison, and ordered to pay back taxes, interest, and penalties totaling more than \$17 million. A second example involves a wealthy and powerful Peruvian family which pressed HBUS to grant a waiver from its AML requirements that bearer share corporations either register their shares or place those shares in bank custody. Bank documents showed how HBUS bankers pressed Compliance personnel to grant the waiver to please a wealthy client. These accounts demonstrate the AML risks associated with bearer share accounts, whose owners seek to hide their identities. Today, following an initiative that concluded in 2011, HBUS has reduced its bearer share accounts to 26, most of which are frozen, while at the same time maintaining a policy that allows the bank to open new bearer share accounts in the future.

**Regulatory Failures.** HBUS' severe AML deficiencies did not happen overnight; they accumulated over time, even though its primary regulator, the OCC, conducted regular AML examinations. Part of the reason HBUS' AML problems were not cured is attributable to certain peculiar and ineffective aspects of the OCC's AML oversight effort.

First, unlike other U.S. bank regulators, the OCC does not treat AML deficiencies as a matter of bank safety and soundness or a management problem. Instead it treats AML deficiencies as a consumer compliance matter, even though AML laws and consumer protection laws have virtually nothing in common. One consequence of this approach is that the OCC considers AML problems when assigning a bank's consumer compliance rating, but not when assigning the bank's management rating or its overall composite rating. As a result, AML deficiencies do not routinely lower the ratings that national banks receive as part of their safety and soundness evaluations, and so do not increase the deposit insurance that banks pay for incurring heightened



risk, contrary to how AML problems are handled at other Federal banking agencies. At HBUS, after citing the bank for severe AML deficiencies, the OCC lowered its consumer compliance rating but not its management rating.

A second problem is that the OCC has adopted a practice of foregoing the citation of a statutory or regulatory violation in its Supervisory Letters and annual Reports of Examination when a bank fails to comply with one of the four mandatory components of an AML program. The four minimum statutory requirements of an AML program are AML internal controls, an AML compliance officer, AML training, and independent testing of the effectiveness of its AML program. By consistently treating a failure to meet one or even several of these statutory requirements as a "Matter Requiring Attention" instead of a legal violation, the OCC diminishes the importance of meeting each requirement, sends a more muted message about the need for corrective action, and makes enforcement actions more difficult to pursue if an AML deficiency persists. In contrast, citing a violation of law when one critical component of a bank's AML program is inadequate sends a strong message to bank management that its AML program is deficient, does not meet minimum statutory requirements, and requires remediation to ensure compliance with the law. At HBUS, the OCC identified 83 Matters Requiring Attention over five years, without once citing a legal violation of Federal AML law. It was only when the OCC found HBUS' entire AML program to be deficient that the OCC finally cited the bank for a legal violation.

Additional problems illustrated by the HBUS case history include the OCC's practice of conducting narrowly focused AML examinations of specific banking units without also assessing HBUS' overall AML program; the OCC's reluctance, despite mounting AML deficiencies, to make timely use of formal and informal enforcement actions to compel improvements in HBUS' AML program; and the practice by some OCC examiners to issue Supervisory Letters that sometimes muted AML examination criticisms or weakened recommendations for AML reforms at HBUS.

While the OCC insists that its AML approach has merit, the HSBC case history, like the Riggs Bank case history examined by this Subcommittee eight years ago,<sup>9</sup> provides evidence that the current OCC system has tolerated severe AML deficiencies for years, permitted national banks to delay or avoid correcting identified problems, and allowed smaller AML issues to accumulate into a massive problem before OCC enforcement action was taken. An experienced OCC AML examiner told the Subcommittee: "I thought I saw it all with Riggs but

<sup>9</sup> See "Money Laundering and Foreign Corruption: Enforcement and Effectiveness of the Patriot Act," U.S. Senate Permanent Subcommittee on Investigations, S.Hrg. 108-633 (July 15, 2004).

HSBC was the worst situation I'd ever seen," yet during the six-year period from 2004 to 2010, OCC officials did not take any formal or informal enforcement action to compel HBUS to strengthen its AML program, essentially allowing its AML problems to fester. In 2009, after learning of two law enforcement investigations involving AML issues at the bank, the OCC suddenly expanded and intensified an ongoing AML examination and allowed it to consider a wide range of AML issues. The OCC examination culminated in the issuance, in September 2010, of a blistering supervisory letter listing numerous, serious AML problems at the bank. In October 2010, the OCC also issued a Cease and Desist Order requiring HBUS to revamp its AML controls.

In response, HBUS has announced a number of key organizational and policy initiatives to improve its AML program in the United States and globally. While those initiatives are promising, HBUS announced similarly promising AML reforms in 2003, when confronted with an AML enforcement action by the Federal Reserve Bank of New York and New York State Banking Department. Even before the OCC lifted that order in 2006, HBUS' AML program deteriorated. Both HBUS and the OCC will have to undertake a sustained effort to ensure the newest round of changes produce a better AML outcome.

HSBC is the quintessential global bank, operating hundreds of affiliates in 80 countries, with its U.S. affiliate acting as the gateway into the U.S. financial system for the entire network. The OCC allowed AML problems at HBUS to build up until they represented major AML vulnerabilities for the United States. Going forward, HBUS needs far stronger controls to ensure it doesn't leave AML risks to the U.S. financial system unattended; and the OCC needs a much better approach to resolve AML problems in a more effective and timely manner.

#### **A. Findings**

This Report makes the following findings of fact.

- (1) Longstanding Severe AML Deficiencies.** HBUS operated its correspondent accounts for foreign financial institutions with longstanding, severe AML deficiencies, including a dysfunctional AML monitoring system for account and wire transfer activity, an unacceptable backlog of 17,000 unreviewed alerts, insufficient staffing, inappropriate country and client risk assessments, and late or missing Suspicious Activity Reports, exposing the United States to money laundering, drug trafficking, and terrorist financing risks.

- (2) **Taking on High Risk Affiliates.** HBUS failed to assess the AML risks associated with HSBC affiliates before opening correspondent accounts for them, failed to identify high risk affiliates, and failed for years to treat HBMX as a high risk accountholder.
- (3) **Circumventing OFAC Prohibitions.** For years in connection with Iranian U-turn transactions, HSBC allowed two non-U.S. affiliates to engage in conduct to avoid triggering the OFAC filter and individualized transaction reviews. While HBUS insisted, when asked, that HSBC affiliates provide fully transparent transaction information, when it obtained evidence that some affiliates were acting to circumvent the OFAC filter, HBUS failed to take decisive action to confront those affiliates and put an end to conduct which even some within the bank viewed as deceptive.
- (4) **Disregarding Terrorist Links.** HBUS provided U.S. correspondent accounts to some foreign banks despite evidence of links to terrorist financing.
- (5) **Clearing Suspicious Bulk Travelers Cheques.** In less than four years, HBUS cleared over \$290 million in sequentially numbered, illegibly signed, bulk U.S. dollar travelers cheques for Hokuriku Bank, which could not explain why its clients were regularly depositing up to \$500,000 or more per day in U.S. dollar travelers cheques obtained in Russia into Japanese accounts, supposedly for selling used cars; even after learning of Hokuriku's poor AML controls, HBUS continued to do business with the bank.
- (6) **Offering Bearer Share Accounts.** Over the course of a decade, HBUS opened over 2,000 high risk bearer share corporate accounts with inadequate AML controls.
- (7) **Allowing AML Problems to Fester.** The OCC allowed HBUS AML deficiencies to fester for years, in part due to treating HBUS AML problems as consumer compliance matters rather than safety and soundness problems, failing to make timely use of formal and informal enforcement actions to compel AML reforms at the bank, and focusing on AML issues in specific HBUS banking units without also viewing them on an institution-wide basis.

## B. Recommendations

This Report makes the following recommendations.

- (1) **Screen High Risk Affiliates.** HBUS should reevaluate its correspondent relationships with HSBC affiliates, including by reviewing affiliate AML and compliance audit findings, identifying high risk affiliates, designating affiliate accounts requiring enhanced monitoring, and closing overly risky accounts. HBUS should conduct a special review of the HBMX account to determine whether it should be closed.
- (2) **Respect OFAC Prohibitions.** HSBC Group and HBUS should take concerted action to stop non-U.S. HSBC affiliates from circumventing the OFAC filter that screens transactions for terrorists, drug traffickers, rogue jurisdictions, and other wrongdoers, including by developing audit tests to detect undisclosed OFAC sensitive transactions by HSBC affiliates.
- (3) **Close Accounts for Banks with Terrorist Financing Links.** HBUS should terminate correspondent relationships with banks whose owners have links to, or present high risks of involvement with, terrorist financing.
- (4) **Revamp Travelers Cheque AML Controls.** HBUS should restrict its acceptance of large blocks of sequentially numbered U.S. dollar travelers cheques from HSBC affiliates and foreign financial institutions; identify affiliates and foreign financial institutions engaged in suspicious travelers cheque activity; and stop accepting travelers cheques from affiliates and foreign banks that sell or cash U.S. dollar travelers cheques with little or no KYC information.
- (5) **Boost Information Sharing Among Affiliates.** HSBC should require AML personnel to routinely share information among affiliates to strengthen AML coordination, reduce AML risks, and combat wrongdoing.
- (6) **Eliminate Bearer Share Accounts.** HBUS should close its remaining 26 bearer share corporate accounts, eliminate this type of account, and instruct financial institutions using HBUS correspondent accounts not to execute transactions involving bearer share corporations. U.S. financial regulators should prohibit U.S. banks from opening or servicing bearer share accounts.

- (7) **Increase HBUS' AML Resources.** HBUS should ensure a full time professional serves as its AML director, and dedicate additional resources to hire qualified AML staff, implement an effective AML monitoring system for account and wire transfer activity, and ensure alerts, including OFAC alerts, are reviewed and Suspicious Activity Reports are filed on a timely basis.
- (8) **Treat AML Deficiencies as a Matter of Safety and Soundness.** The OCC should align its practice with that of other Federal bank regulators by treating AML deficiencies as a safety and soundness matter, rather than a consumer compliance matter, and condition management CAMELS ratings in part upon effective management of a bank's AML program.
- (9) **Act on Multiple AML Problems.** To ensure AML problems are corrected in a timely fashion, the OCC should establish a policy directing that the Supervision Division coordinate with the Enforcement and Legal Divisions to conduct an institution-wide examination of a bank's AML program and consider use of formal or informal enforcement actions, whenever a certain number of Matters Requiring Attention or legal violations identifying recurring or mounting AML problems are identified through examinations.
- (10) **Strengthen AML Examinations.** The OCC should strengthen its AML examinations by citing AML violations, rather than just Matters Requiring Attention, when a bank fails to meet any one of the statutory minimum requirements for an AML program; and by requiring AML examinations to focus on both specific business units and a bank's AML program as a whole.

## II. GENERAL BACKGROUND

This section provides a general overview of HSBC Group, HSBC Bank USA (HBUS), and the HBUS compliance and anti-money laundering (AML) program.

### A. Background on HSBC Group and HBUS

HSBC Group is one of the largest financial institutions in the world, with over \$2.5 trillion in assets, 89 million customers, and 2011 profits of nearly \$22 billion.<sup>10</sup> Its parent corporation, HSBC Holdings plc, often referred to by the bank as "HSBC Group," is headquartered in London. Despite its London headquarters, the principal office of the Group Chief Executive is located in Hong Kong.<sup>11</sup> Altogether, HSBC has about 300,000 employees and 7,200 offices in over 80 countries, including North America, Europe, Asia, Latin America, the Middle East, and Africa.<sup>12</sup>

**United States Operations.** Among other entities, the Group owns HSBC Overseas Holdings (UK) Ltd. (HSBC Overseas Holdings), which oversees its operations in the United States and Canada. HSBC Overseas Holdings owns, in turn, HSBC North America Holdings Inc. (HNAH, pronounced "Hannah"), one of the ten largest bank holding companies in the United States. HNAH has assets of about \$345 billion, is headquartered in New York City, and is overseen by the Federal Reserve.<sup>13</sup> Through various subsidiaries, HNAH owns three key HSBC financial institutions in the United States: HSBC Bank USA N.A. (HBUS); HSBC Securities (USA) Inc. (HSBC Securities); and HSBC Finance Corporation.

HBUS operates more than 470 bank branches throughout the United States, manages assets totaling about \$210 billion, and serves around 4 million customers.<sup>14</sup> It holds a national bank charter and its

<sup>10</sup> See "HSBC Holdings plc 2011 Results-Highlights," (2/12/12), at 1-2, [http://www.hsbc.com/1/PA\\_esf-ca-app-content/content/assets/investor\\_relations/hsbc2011arn.pdf](http://www.hsbc.com/1/PA_esf-ca-app-content/content/assets/investor_relations/hsbc2011arn.pdf); "HSBC Holdings plc Annual Report and Accounts 2011," at 1, [http://www.hsbc.com/1/PA\\_esf-ca-app-content/content/assets/investor\\_relations/hsbc2011ara0.pdf](http://www.hsbc.com/1/PA_esf-ca-app-content/content/assets/investor_relations/hsbc2011ara0.pdf) (hereinafter "HSBC Group 2011 Annual Report").

<sup>11</sup> See "HSBC Announces New Leadership Team," (9/24/10), media release prepared by HSBC, <http://www.hsbc.com/1/2/newsroom/news/2010/hsbc-announces-new-leadership>.

<sup>12</sup> HSBC Group 2011 Annual Report at 1; "HSBC Announces New Leadership Team," (9/24/10), media release prepared by HSBC, <http://www.hsbc.com/1/2/newsroom/news/2010/hsbc-announces-new-leadership>.

<sup>13</sup> See "HSBC North America Holdings Inc. Fact Sheet," at 1, [http://www.us.hsbc.com/1/PA\\_1\\_083Q9FJ08A002FBP5S00000000/content/usshared/Inside%20HSBC/About%20HSBC/Corporate%20Information/Corporate%20Facts/hnah\\_factsheet\\_0911.pdf](http://www.us.hsbc.com/1/PA_1_083Q9FJ08A002FBP5S00000000/content/usshared/Inside%20HSBC/About%20HSBC/Corporate%20Information/Corporate%20Facts/hnah_factsheet_0911.pdf).

<sup>14</sup> "HSBC Bank USA, National Association Fact Sheet," at 1, [http://www.us.hsbc.com/1/PA\\_1\\_083Q9FJ08A002FBP5S00000000/content/usshared/Inside%20HSBC/About%20HSBC/Corporate%20Information/Corporate%20Facts/hbus\\_factsheet\\_0911.pdf](http://www.us.hsbc.com/1/PA_1_083Q9FJ08A002FBP5S00000000/content/usshared/Inside%20HSBC/About%20HSBC/Corporate%20Information/Corporate%20Facts/hbus_factsheet_0911.pdf) (hereinafter "HBUS Fact Sheet").

primary regulator is the Office of the Comptroller of the Currency (OCC), which is part of the U.S. Treasury Department. Because it holds insured deposits, its secondary regulator is the Federal Deposit Insurance Corporation (FDIC). HBUS is the principal subsidiary of HSBC USA Inc. (HUSI), a bank holding company which is a wholly-owned subsidiary of HNAH.<sup>15</sup> HBUS is headquartered in McLean, Virginia, and has its principal office in New York City.<sup>16</sup>

HSBC Securities is a licensed broker-dealer regulated by the Securities and Exchange Commission (SEC). HSBC Finance Corporation, formerly subprime lender Household International, provides credit cards, automobile loans, consumer lending, and insurance products, and is overseen by several U.S. regulators including the Consumer Financial Protection Bureau.

HNAH also owns an Edge Act corporation in Miami, HSBC Private Bank International.<sup>17</sup> The Edge Act allows U.S. national banks to form U.S. subsidiaries designed to engage solely in international banking operations, including holding deposits for non-U.S. persons.<sup>18</sup> Edge Act corporations are chartered and regulated by the Federal Reserve. In addition, HNAH sponsors the HSBC Latin American International Center, also referred to as “HSBC Miami Offshore,” in Miami. This center, like HSBC Private Bank International, is designed to help meet the needs of Latin American clients with banking needs in the United States.<sup>19</sup>

HNAH owns several other subsidiaries as well, including HSBC Trust Company, N.A., of Delaware, and HSBC Bank Nevada, N.A., of Las Vegas, Nevada.

**HBUS Major Lines of Business.** HBUS has six major lines of business in the United States.<sup>20</sup> The first is “Retail Banking and Wealth Management” which provides deposits, checking, savings, mortgages, loans, brokerage products, and certificates of deposit (CDs) to customers.<sup>21</sup> HSBC Premier is a product within the retail bank that provides services for more affluent clients.<sup>22</sup>

<sup>15</sup> Id.

<sup>16</sup> Id. at 2.

<sup>17</sup> See “FAQs – HSBC Money Laundering Enforcement Action,” attached to 10/6/2010 email from OCC James Vivencio to OCC colleagues, “HSBC FAQs,” OCC-PSI-00898845-857.

<sup>18</sup> See the Edge Act, P.L. 102-242 (1919), codified at 12 U.S.C. § 611 et seq.

<sup>19</sup> See HSBC Latin American International Center website, <https://www.us.hsbc.com/1/2/3/hsbcpremier/miami-offshore>.

<sup>20</sup> HBUS Fact Sheet at 1-2. According to the OCC, HBUS has a total of 32 lines of business altogether. Subcommittee interviews of OCC examiners Joseph Boss (1/30/2012) and Elsa de la Garza (1/9/2012).

<sup>21</sup> See <https://www.us.hsbc.com/1/2/3/hsbcpremier/miami-offshoreretail>.

<sup>22</sup> HBUS Fact Sheet at 1.

The HBUS “Private Banking” offers wealth management services for high net worth individuals and families with deposits of at least \$1 million.<sup>23</sup> HSBC Private Bank provides banking, investment, custody, wealth planning, trust and fiduciary, insurance, and philanthropic advisory services to its customers.<sup>24</sup> Clients receive a dedicated “relationship manager” to manage their Private Bank accounts.

The HBUS “Commercial Banking” offers global banking services to financial institutions, companies, governmental entities, and non-profit organizations worldwide.<sup>25</sup> These services include deposits, checking, remote deposit capture, payments and cash management, pouch services, corporate loans and financing, merchant services, and insurance products. HBUS assigns each client a dedicated relationship manager to handle its accounts.<sup>26</sup>

The HBUS “Global Banking and Markets” line of business, with offices in more than 60 countries, provides a wide range of “tailored financial solutions” to major government, corporate, and institutional clients.<sup>27</sup> This line of business includes an extensive network of correspondent banking relationships, in which HBUS provides banks from other countries with U.S. dollar accounts to transact business in the United States. Due to its affiliates in over 80 countries, HSBC is one of the largest providers of correspondent banking services in the world. In 2010, it had about 2,400 correspondent customers, including for more than 80 HSBC affiliates.<sup>28</sup> Among other services, HSBC provides financial institution clients with access to the U.S. financial system by handling international wire transfers, clearing a variety of U.S. dollar instruments, including travelers cheques and money orders, and providing foreign exchange services. HBUS Payment and Cash Management (PCM) is a key banking division, located in New York, that supports HBUS’ correspondent relationships.<sup>29</sup>

In addition, as part of this line of business, until 2010, HBUS housed the Global Banknotes Department, which used offices in New York City, London, Hong Kong, and elsewhere to buy, sell, and ship

<sup>23</sup> Id. at 2; Subcommittee interview of HSBC representatives (6/9/2011).

<sup>24</sup> HBUS Fact Sheet at 2.

<sup>25</sup> HBUS Fact Sheet at 1.

<sup>26</sup> Id.

<sup>27</sup> Id.

<sup>28</sup> See 9/13/2010 OCC Supervisory Letter HSBC-2010-22, “Bank Secrecy Act/Anti-Money Laundering (‘BSA/AML’) Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21),” OCC-PSI-00864335-365, at 7. [Sealed Exhibit.] Subcommittee briefing by HSBC legal counsel (6/20/2012).

<sup>29</sup> 9/13/2010 OCC Supervisory Letter HSBC-2010-22, “Bank Secrecy Act/Anti-Money Laundering (‘BSA/AML’) Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21),” OCC-PSI-00864335-365, at 341-342 [Sealed Exhibit.]; Subcommittee interview of Michael Gallagher (6/13/2012).



large amounts of physical U.S. dollars.<sup>30</sup> The Banknotes Department derived its income from the trading, transportation, and storage of bulk cash, doing business primarily with other banks and currency exchange businesses, but also with HSBC affiliates.<sup>31</sup> In addition, for a number of years, HBUS held a contract with the U.S. Federal Reserve Bank of New York (FRBNY) to operate U.S. currency vaults in several cities around the world to assist in the physical distribution of U.S. dollars to central banks, large commercial banks, and businesses involved with currency exchange.<sup>32</sup> In June 2010, however, HBUS exited the wholesale U.S. banknotes line of business, later selling portions of the business to other banks.<sup>33</sup> It also did not renew its contract to operate FRBNY currency vaults.

The HBUS "Global Asset Management" line of business offers worldwide investment management services to clients, and currently manages nearly \$400 billion in assets.<sup>34</sup> It is one of the largest investment businesses in the world. Finally, "HSBC Insurance" provides a wide variety of insurance products to customers in the United States and Canada.<sup>35</sup>

In addition to these major lines of business, in recent years, HBUS has become a leader in providing banking services to foreign embassies with a presence in the United States. HBUS began this business after Riggs Bank and Wachovia Bank stopped providing those services in 2005, and embassies began looking for a new financial institution.<sup>36</sup>

Through its correspondent banking and Payments and Cash Management (PCM) businesses, HBUS has become one of the largest facilitators of cash transfers in the world. Between 2005 and 2009, the total number of PCM wire transactions at HBUS grew from 20.4 million to 30.2 million transfers per year, with a total annual dollar volume that climbed from \$62.4 trillion to \$94.5 trillion.<sup>37</sup> In 2008, HBUS processed

<sup>30</sup> See 9/13/2010 OCC Supervisory Letter HSBC-2010-22, OCC-PSI-00864335-365, at 341-342. [Sealed Exhibit.]

<sup>31</sup> Id. at OCC-PSI-00864342.

<sup>32</sup> See Form 10-Q filed by HSBC USA Inc. with the SEC for the quarter ending June 30, 2011, at 9-10.

<sup>33</sup> Id. In 2010, HSBC Holdings plc sold its U.S. wholesale banknotes business in Asia to United Overseas Bank Limited (UOB) for \$11 million, and in 2011, sold its European banknotes business to HSBC Bank plc. It recorded total closure costs of \$14 million during 2010. Id.

<sup>34</sup> HBUS Fact Sheet at 2.

<sup>35</sup> Id.

<sup>36</sup> See 1/30/2006 OCC Supervisory Letter regarding HBUS Embassy Banking, OCC-PSI-00107529-736, at 529-530; "HSBC to Open D.C. Branch, Pursue Embassy Clients," Washington Post, Terence O'Hara (10/5/2004)(quoting Riggs spokesperson: "As a service to our remaining embassy clients, Riggs is working closely with HSBC to ensure a smooth transition."), <http://www.washingtonpost.com/ac2/wp-dyn/A7285-2004Oct4?language=printer>.

<sup>37</sup> See 9/13/2010 OCC Supervisory Letter HSBC-2010-22, "Bank Secrecy Act/Anti-Money Laundering ('BSA/AML') Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21)," OCC-PSI-00864335-365, at 7. [Sealed Exhibit.]

about 600,000 wire transfers per week.<sup>38</sup> In 2009, PCM was the third largest participant in the CHIPS wire transfer service which provides over 95% of U.S. dollar wire transfers across U.S. borders and nearly half of all wire transfers within the United States, totaling \$1.5 trillion per day and over \$400 trillion in 2011.<sup>39</sup>

**HSBC Affiliates.** HSBC has hundreds of affiliates located in over 80 countries. At least 80 HSBC affiliates have turned to HBUS for access to U.S. dollars and the U.S. financial system. These affiliates typically interact with HBUS by opening a correspondent account at HBUS headquarters in New York. Many use the account to clear U.S. dollars wire transfers; some use the account to cash U.S. dollar instruments like travelers cheques or money orders; still others use the account for foreign exchange purposes. In addition, some opened a separate account to buy or sell physical U.S. dollars as part of HBUS' wholesale banknotes business, until it was shuttered in 2010.

HSBC affiliates have accounted for a large portion of HBUS' U.S. dollar activities. In 2009, for example, HSBC determined that "HSBC Group affiliates clear[ed] virtually all USD [U.S. dollar] payments through accounts held at HBUS, representing 63% of all USD payments processed by HBUS."<sup>40</sup> HSBC also calculated that, over an eight-year period, its U.S. dollar clearing business had increased over 200%, from processing an average daily amount of \$185 billion in 2001, to \$377 billion in 2009.<sup>41</sup> HBUS also executes transactions through HSBC affiliates in other countries. It has been estimated that, in 2009, HBUS processed 19.4 million transactions, involving \$45.9 trillion, through HSBC affiliates.<sup>42</sup>

One of the largest HSBC affiliates is The Hongkong Shanghai Banking Corporation Ltd., which is incorporated in Hong Kong and is Hong Kong's largest bank.<sup>43</sup> Established in 1865, when Hong Kong was part of the British empire, it is the founding member of the HSBC Group, but now operates as a subsidiary of HSBC Holdings plc, the Group's parent corporation. With more than 71,400 employees, it oversees a network of hundreds of HSBC affiliates in 20 countries

<sup>38</sup> See 7/28/2008 OCC memorandum, "OFAC Examination – Payment and Cash Management (PCM)," OCC-PSI-01274962, at 4. [Sealed Exhibit.]

<sup>39</sup> Id. See also The Clearing House website, "About CHIPS," <http://www.chips.org/about/pages/033738.php>.

<sup>40</sup> See 9/9/2009 chart entitled, "HSBC Profile," included in "HSBC OFAC Compliance Program," a presentation prepared by HSBC and provided to the OCC, at HSBC OCC 8874197.

<sup>41</sup> Id. at "USD Payment Statistics – Fact Sheet," HSBC OCC 8874211.

<sup>42</sup> See 9/13/2010 OCC Supervisory Letter HSBC-2010-22, "Bank Secrecy Act/Anti-Money Laundering ('BSA/AML') Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21)," OCC-PSI-00864335-365, at 7. [Sealed Exhibit.]

<sup>43</sup> See "Hongkong Shanghai Banking Corporation Limited Annual Report and Accounts 2011," at 2, [http://www.hsbc.com.hk/1/PA\\_1\\_3\\_SS/content/about/financial-information/financial-reports/bank/pdf/2011report.pdf](http://www.hsbc.com.hk/1/PA_1_3_SS/content/about/financial-information/financial-reports/bank/pdf/2011report.pdf).

throughout Asia and the Pacific Region, including Australia, Bangladesh, China, India, Japan, Malaysia, New Zealand, Thailand, and Vietnam.<sup>44</sup> It is sometimes referred to in internal HSBC documents as HBAP, an abbreviation for HSBC Bank Asia Pacific.

A second key affiliate is HSBC Bank Middle East Ltd. (HBME). Incorporated in Jersey in the Channel Islands and owned through a chain of subsidiaries reaching back to the Group's parent corporation in London, HBME oversees a network of financial institutions throughout the Middle East and North Africa.<sup>45</sup> With more than 5,000 employees, HBME provides banking services through nearly 45 branches in Algeria, Bahrain, Jordan, Kuwait, Lebanon, Oman, Pakistan, Qatar, and the United Arab Emirates.<sup>46</sup> In 1998, HSBC Group established "HSBC Amanah," a "global Islamic financial services division" designed to "serve the particular needs of Muslim communities" in compliance with Islamic law.<sup>47</sup> HBME offers Amanah banking services to many of its clients in the Middle East and North Africa.

A third affiliate discussed in this Report is HSBC Mexico S.A. Banco (HBMX), the principal operating company of Grupo Financiero HSBC, S.A. de C.V., which owns HSBC's businesses in Mexico. HSBC's Mexican group is one of Mexico's largest financial service conglomerates, with over 1,000 branches throughout the country, nearly \$2 billion in assets, and over 8 million clients.<sup>48</sup> HSBC purchased HBMX in 2002, when it operated under the name of Banco Internacional, S.A. and was part of Grupo Financiero Bital, S.A. de C.V.<sup>49</sup> HBMX and its Mexican parent are headquartered in Mexico City and together have about 19,000 employees.<sup>50</sup>

**HSBC Leadership.** Over the last few years, HSBC leadership has undergone significant change. In 2010, HSBC Holdings plc appointed a

<sup>44</sup> Id.

<sup>45</sup> See "HSBC Bank Middle East Limited Annual Report and Accounts 2011," [http://www.hsbc.ae/1/PA\\_1\\_083Q9FJ08A002FBP5S00000000/content/uae\\_pws/pdf/en/annual\\_report\\_2011.pdf](http://www.hsbc.ae/1/PA_1_083Q9FJ08A002FBP5S00000000/content/uae_pws/pdf/en/annual_report_2011.pdf).

<sup>46</sup> See id. at 32. See also "HSBC Wins its Eighth Best Cash Management Bank in the Middle East Award," <http://www.hsbc.ae/1/2/about-hsbc/newsroom/eighth-best-cash-management>, viewed 4/2/12; "HSBC Research Picks Up More Regional Awards," (1/12/12), [http://www.hsbc.ae/1/PA\\_1\\_083Q9FJ08A002FBP5S00000000/content/uae\\_pws/pdf/en/newsroom/euromoney-research-awards-jan-12.pdf](http://www.hsbc.ae/1/PA_1_083Q9FJ08A002FBP5S00000000/content/uae_pws/pdf/en/newsroom/euromoney-research-awards-jan-12.pdf), viewed 4/12/12. HSBC provides banking services in Saudi Arabia through both HSBC Saudi Arabia, in which it is a 49% shareholder, and Saudi British Bank (SABB), in which it is a 40% shareholder. See "HSBC Research Picks Up More Regional Awards," (1/12/12), [http://www.hsbc.ae/1/PA\\_1\\_083Q9FJ08A002FBP5S00000000/content/uae\\_pws/pdf/en/newsroom/euromoney-research-awards-jan-12.pdf](http://www.hsbc.ae/1/PA_1_083Q9FJ08A002FBP5S00000000/content/uae_pws/pdf/en/newsroom/euromoney-research-awards-jan-12.pdf), viewed 4/12/12.

<sup>47</sup> See HSBC website, "About HSBC Amanah," <http://www.hsbcamanah.com/amanah/about-amanah>.

<sup>48</sup> See HSBC website, Grupo HSBC México, <http://www.hsbc.com.mx/1/2/grupo>, viewed 4/2/12.

<sup>49</sup> See "HSBC Consuma la Adquisición de GF BITAL," (11/25/02), [http://www.hsbc.com.mx/1/PA\\_1\\_1\\_S5/content/home\\_en/investor\\_relations/press\\_releases/infpress/hsbc\\_consumo.pdf](http://www.hsbc.com.mx/1/PA_1_1_S5/content/home_en/investor_relations/press_releases/infpress/hsbc_consumo.pdf).

<sup>50</sup> See HSBC website, Grupo HSBC México, <http://www.hsbc.com.mx/1/2/grupo>, viewed 4/2/12.

new Chairman of the Board of Directors, Douglas J. Flint, replacing Stephen Green, who had become a U.K. Cabinet Minister.<sup>51</sup> A new Group Chief Executive was also selected, replacing Michael Geoghegan, who retired, with Stuart T. Gulliver. In 2012, HSBC Holdings plc also appointed a new Chief Legal Officer, Stuart Levey, former Undersecretary for Terrorism and Financial Intelligence at the U.S. Treasury Department. Mr. Levey replaced the Group's General Counsel, Richard Bennett.<sup>52</sup>

Also in 2010, Sandy Flockhart became Chairman of Europe, Middle East, Africa, Latin America, Commercial Banking; as well as Chairman of HSBC Bank plc.<sup>53</sup> Mr. Flockhart, who first joined HSBC in 1974, is an emerging markets specialist and, among other posts, headed HBMX in Mexico for five years, from 2002 to 2007.<sup>54</sup> He was also appointed to the HSBC Group Board of Directors in 2008, and became a director of HSBC Bank Middle East in July 2011.<sup>55</sup>

**HNAH Leadership.** At HNAH, the U.S. bank holding company, the persons holding leadership positions have often overlapped with those of HNAH's key subsidiaries, HBUS, HSBC Securities, and HSBC Finance Corporation. HNAH's current Chief Executive Officer (CEO), for example, is Irene Dorner, who is also the CEO of HBUS.<sup>56</sup> Her immediate predecessor at HNAH, for less than a year, was Niall Booker, who was preceded by Brendan McDonagh, former Chief Operating Officer (COO) of HBUS. Before Mr. McDonagh, HNAH was headed by Siddharth (Bobby) N. Mehta, who was also head of HSBC Finance Corporation, but left the bank when HSBC Finance Corporation's subprime mortgage portfolio incurred huge losses during the recent financial crisis.

The current HNAH COO is Gregory Zeeman; the current General Counsel is Stuart Alderoty; and the current Chief Auditor is Mark Martinelli, each of whom currently holds the same position at HBUS.<sup>57</sup>

<sup>51</sup> See "HSBC Announces New Leadership Team," (9/24/10), media release prepared by HSBC, <http://www.hsbc.com/1/2/newsroom/news/2010/hsbc-announces-new-leadership>.

<sup>52</sup> "HSBC appoints Chief Legal Officer," (1/13/12), media release prepared by HSBC, <http://www.hsbc.com/1/2/newsroom/news/2012/chief-legal-officer>. Mr. Levey held his position at the Treasury Department from July 2004 to February 2011. *Id.* Mr. Bennett had headed HSBC Group's Legal and Compliance department since 1998; in 2010, he had become General Counsel.

<sup>53</sup> See "HSBC Announces New Leadership Team," (9/24/10), media release prepared by HSBC, <http://www.hsbc.com/1/2/newsroom/news/2010/hsbc-announces-new-leadership>.

<sup>54</sup> See HSBC Group "Board of Directors," <http://www.hsbc.com/1/2/about/board-of-directors> (describing Mr. Flockhart as "a career banker, being an emerging markets specialist with over 35 years' experience with HSBC in Latin America, the Middle East, US and Asia").

<sup>55</sup> *Id.*

<sup>56</sup> See "Leadership: HSBC North America Holdings Inc.," <https://www.us.hsbc.com/1/2/3/personal/inside/about/corporate-information/leadership/hnah>.

<sup>57</sup> *Id.*

HNAH's Chief Risk Officer is Mark Gunton who holds the same position at both HBUS and HSBC Finance Corporation.

**HBUS Leadership.** Over the last ten years, HBUS has undergone numerous changes in leadership, with the head of the bank turning over four times.<sup>58</sup> The current head is Irene Dorner who serves as HBUS' Chairman of the Board, President, and CEO. She was appointed to those positions in 2010, after having served as the CEO of HSBC Bank Malaysia and as a director on the HBUS Board. Her immediate predecessor was Paul J. Lawrence who headed HBUS from 2007 to 2010. His predecessor was Sandy L. Derickson who served in the post for less than one year and left the bank along with Mr. Mehta after HSBC Finance Corporation, where he was second-in-command, incurred substantial losses. His predecessor was Martin J.G. Glynn who headed HBUS from 2003 to 2006, and then retired.

HBUS has a six-person Board of Directors. Its current members are Ms. Dorner; William R.P. Dalton, former CEO of HSBC Bank plc in London; Anthea Disney, former Executive Vice President of NewsCorporation; Robert Herdman, former SEC Chief Accountant; Louis Hernandez, Jr., CEO of Open Solutions Inc.; and Richard A. Jalikut, CEO of TelePacific Communications.

Within HBUS, the current Chief Operating Officer (COO) is Gregory Zeeman.<sup>59</sup> His immediate predecessor was David Dew<sup>60</sup> who was preceded by Brendan McDonagh, who served as the COO from 2004 to 2006. Some other key HBUS executives are Marlon Young, the head of Private Banking Americas; Kevin Martin, the head of Retail Banking and Wealth Management; and Mark Watkinson, the head of Commercial Banking.<sup>61</sup> Since 2007, the bank's Chief Auditor has been Mark Martinelli. From 2000 to 2011, the head of HBUS Payments and Cash Management (PCM) was Michael Gallagher. The head of Global Banknotes, from 2001 to 2010, was Christopher Lok.

HBUS' current General Counsel is Stuart A. Alderoty.<sup>62</sup> His predecessor was Janet Burak who served as the bank's General Counsel

<sup>58</sup> Information on HBUS' leadership is taken from its SEC annual reports.

<sup>59</sup> See "Leadership: HSBC Bank USA, N.A.,"

<https://www.us.hsbc.com/1/2/3/personal/inside/about/corporate-information/leadership/hbus>.

<sup>60</sup> Mr. Dew served as HBUS COO from March 2007 to 2008; prior to that, he served for a month as HBUS Chief Administrative Officer from February 2007 to March 2007; prior to that he served as audit head at HUSI and HSBC North America Inc. from 2006 to 2007, and as audit head of HSBC North America Holdings Inc. from 2004 to 2007. Mr. Dew currently works as Managing Director of the Saudi British Bank which is 40% owned by HSBC. Subcommittee interview of David Dew (3/5/2012).

<sup>61</sup> See "2011 HSBC Annual Report,"

<http://www.us.hsbc.com/1/2/3/personal/inside/about/corporate-information/leadership/hbus>, viewed 3/23/12.

<sup>62</sup> See "Leadership: HSBC Bank USA, N.A.,"

<https://www.us.hsbc.com/1/2/3/personal/inside/about/corporate-information/leadership/hbus>.

from 2004 to 2010. In 2007, she was also made the Regional Compliance Officer for North America.<sup>63</sup>

## **B. HBUS AML Program**

The compliance and anti-money laundering (AML) programs at HBUS have undergone continual organizational and leadership changes since 2005. In April 2003, the Federal Reserve and New York State Banking Department, which oversaw HBUS' predecessor bank, cited the bank for multiple, severe AML deficiencies and required it to enter into a written agreement to revamp and strengthen its AML program.<sup>64</sup> It was at that time that HBUS renamed itself and converted to a national bank charter under the supervision of the OCC. During its first year under OCC supervision, HBUS reorganized its AML program, revamping its AML controls, country and client risk assessment criteria, Know Your Customer (KYC) due diligence requirements, and systems for detecting and reporting suspicious activity.<sup>65</sup> HBUS also acquired a new system for monitoring account activity, called the Customer Activity Monitoring Program (CAMP) and established criteria to produce alerts requiring additional reviews. In addition, HBUS created a system of KYC client profiles with standard due diligence information requirements for each client and which was updated on a regular basis and had to be approved by compliance and other bank officials for an account to be kept open. HBUS also established a Financial Intelligence Group to conduct enhanced due diligence reviews.

Although the OCC gave positive reviews to the bank's initial efforts,<sup>66</sup> by 2010, the OCC issued a lengthy Supervisory Letter again citing the bank for numerous AML deficiencies and requiring HBUS to revamp its AML program a second time. In response, the bank issued an action plan to correct identified problems. HBUS has, for example, acquired a new AML monitoring system, NORKOM to replace CAMP, and is working to refine its parameters for detecting suspicious activity. In its first month of operation, NORKOM detected more than 100,000 transactions needing further review, demonstrating its ability to catch many transactions that went previously unchecked under CAMP.

HBUS has also revamped its approach to HSBC affiliates, which make up an important segment of HBUS' correspondent banking, wire

<sup>63</sup> See 9/13/2010 OCC Supervisory Letter HSBC-2010-22, "Bank Secrecy Act/Anti-Money Laundering ('BSA/AML') Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21).," OCC-PSI-00000230-259, at 256. [Sealed Exhibit.]

<sup>64</sup> See HSBC Bank USA, Federal Reserve Bank of New York, and New York State Banking Department, Docket No. 03-012-WA/RB-SM (Board of Governors of the Federal Reserve System, Washington, D.C.), Written Agreement (4/30/2003), OCC-PSI-00907803-811.

<sup>65</sup> See OCC Report of Examination of HBUS, for the examination cycle ending March 31, 2005, OCC-PSI-00423650. [Sealed Exhibit.]

<sup>66</sup> Id. at 10-11 (describing the formal agreement).

transfer, and cash management businesses and previously operated without due diligence controls and at times with minimal or no AML monitoring. Among other changes, HBUS now requires all subsidiaries to conduct due diligence on all other HSBC affiliates, including by using internal audit information identifying their AML risks and AML controls; identifies affiliates posing high AML risks; and treats them accordingly, thus ending all policies exempting affiliates from standard AML account and wire transfer monitoring. In addition, HBUS has revamped its country and client risk assessment criteria, which now identify high risk clients in a more robust manner; reviewed its correspondent banking business to reduce the number of high risk financial institutions; and closed some high risk business lines including its U.S. banknotes program. HBUS has also hired new AML leadership and significantly expanded its AML staffing and resources. HBUS currently employs over 1,000 compliance personnel.<sup>67</sup>

Some of HBUS' changes have been criticized by the OCC as inadequate. HBUS has been informed by the OCC that it must do additional work on its monitoring system in order to implement the requirements of the 2010 Cease and Desist Order. The individual hired by HBUS in 2011 to serve as its Chief Compliance Officer left after a little more than a year. Both HBUS and the OCC will have to work hard to ensure that the latest round of changes will produce a better AML outcome than the changes made in 2004.

### **(1) HBUS Compliance and AML Leadership**

Over the last five years, HBUS has experienced high turnover in its Compliance and AML leadership, making reforms difficult to implement. Since 2007, HBUS has had four Compliance heads and five AML directors. Currently, both positions are held by the same person, Gary Peterson. Mr. Peterson has extensive AML experience and was hired in 2010, to be the AML director, but after the Compliance head was asked to leave in 2010, has since held both posts. In 2012, Mr. Peterson is expected to relinquish his duties as AML director to his deputy, Alan Schienberg, so that the top Compliance and AML positions at HBUS will each have a full time professional.<sup>68</sup>

The top compliance position at HBUS is the Chief Compliance Officer who oversees all compliance issues for the bank. In the AML field, HBUS has specified two posts which have been held by the same person, the Anti-Money Laundering (AML) Director who is tasked with ensuring bank compliance with U.S. AML laws and regulatory

<sup>67</sup> See 7/10/2012 HSBC Group News, "HSBC to Testify at U.S. Senate Hearing," letter by HSBC Group Chief Executive Stuart Gulliver, PSI-HSBC-76-0001-002, at 002.

<sup>68</sup> See HSBC website, "Leadership: HSBC Bank USA, N.A.," <https://www.us.hsbc.com/1/2/3/personal/inside/about/corporate-information/leadership/hbus>.

requirements.<sup>69</sup> HBUS' Compliance and AML leadership positions were relatively stable until 2007, after which the bank has struggled to hire and retain experienced compliance professionals.

HBUS' Chief Compliance Officer from 2000 to 2008 was Carolyn Wind. Prior to that position, Ms. Wind worked for Republic Bank of New York as a compliance officer and, before that, as an OCC bank examiner. For the first three years she held the job, Ms. Wind also served as the AML Director. In 2003, the bank hired a separate AML Director, Teresa Pesce, who served in that post nearly four years, from 2003 to March 2007. Before taking the position at the bank, Ms. Pesce was a Federal prosecutor with the U.S. Attorney's Office in New York. Ms. Pesce left the bank in 2007, after which Ms. Wind headed both the Compliance and AML Compliance functions until she left the bank in 2008. As discussed below, Ms. Wind was dismissed by HBUS after raising the issue of inadequate AML resources with the audit committee of the board of directors of the bank's holding company, HNAH.

In 2007, as part of a "Compliance Transformation Initiative," HSBC established a North America Compliance department at HNAH headed by a Regional Compliance Officer.<sup>70</sup> HNAH appointed Janet Burak, then Regional Legal Department Head for North America, to also serve as the Regional Compliance Officer; she held both positions from 2007 to 2010.<sup>71</sup> At the time, HSBC Group Compliance head David Bagley expressed concern about combining the two roles, arguing that each required too much effort for a single person, but was overruled.<sup>72</sup> Two years later, in March 2009, the Federal Reserve issued a negative critique of Ms. Burak's performance, noting in particular that she did not have an adequate understanding of AML risk or controls.<sup>73</sup> The OCC

<sup>69</sup> The AML Director also serves as HBUS' Bank Secrecy Act Compliance Officer.

<sup>70</sup> See also Federal Reserve, at BOG-A-205485.

<sup>71</sup> See 9/13/2010 OCC Supervisory Letter HSBC-2010-22, "Bank Secrecy Act/Anti-Money Laundering ('BSA/AML') Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21)," OCC-PSI-00864335-365, at 27. [Sealed Exhibit.]

<sup>72</sup> See 6/21/2007 email from HSBC David Bagley to HSBC Richard Bennett, HSBC OCC 8873871-5 (conveying to HSBC Group's most senior legal counsel, Richard Bennett, the concern of HBUS compliance personnel about "the capability of one person to manage a very large legal function and a compliance function" and that "compliance will be pushed down below Legal"). See also 7/28/2010 email from HSBC David Bagley to HSBC Michael Geoghegan, HSBC OCC 8873871-75 (expressing to HSBC CEO Michael Geoghegan, that with regard to the 2007 decision to combine the two roles into one: "I fully accepted that Brendan [McDonagh], Paul [Lawrence] and Richard [Bennett] had the right to make this call, although as I said to you in Vancouver I now wish I had been more vociferous and in the current way my role operates I am confident that I would have a far stronger say.").

<sup>73</sup> The March 2009 Federal Reserve's Summary of Ratings stated: "Interviews conducted as part of our recent governance review revealed that Janet Burak, HNAH Legal and Compliance chief risk officer has only broad understanding of BSA/AML risk and relies on the HNAH BSA/AML officer [Midzain] to manage the risk. ... Midzain, as previously stated has weak BSA/AML knowledge and industry experience. Burak's heavy reliance on the inexperienced Midzain is a concern. An example of Burak's limited management oversight of BSA/AML was revealed when we recently met with her to clarify a few items from our Governance review she was unable to respond to the question about the distribution and the purpose of annual AML



also later criticized her performance as well as the decision to combine the regional legal and compliance roles, noting in 2010, that Ms. Burak “has had to balance a wide range of legal and compliance duties, including establishing the strategic direction for both functions and representing both functions on senior committees at the Group level.”<sup>74</sup> The OCC stated that, as a consequence, Ms. Burak had “not regularly attended key committee or compliance department meetings” and had failed to keep herself and other bank executives “fully informed about issues and risks within the BSA/AML compliance program.”<sup>75</sup> It also placed some of the blame at her feet for a recently discovered backlog of 17,700 alerts indicating possible suspicious activity at the bank, which had not been reviewed, noting that “[b]acklogged alerts needed to receive the highest level of attention from senior bank management at a much earlier stage to ameliorate the problem.”<sup>76</sup> Soon after this critique, Ms. Burak left the bank.

In the two years she held the regional posts, Ms. Burak oversaw three functional compliance teams at HNAH called “Compliance Advisory,” “Compliance Center of Excellence,” and “Compliance Shared Services Utility.”<sup>77</sup> Each team was headed by a senior Compliance manager: Curt Cunningham, Anthony Gibbs, and Lesley Midzain.

Ms. Midzain was hired in 2007 to replace Carolyn Wind and so worked, not only for HNAH, but also for HBUS as both its Compliance head and AML director. She held these compliance posts for two years, from 2007 until 2009. Prior to being placed at the helm of the bank’s AML program, Ms. Midzain had no professional experience and little familiarity with U.S. AML laws. In December 2008, HNAH’s regulator, the Federal Reserve, provided a negative critique of Ms. Midzain’s management of the bank’s AML program. The Federal Reserve wrote that Ms. Midzain did “not possess the technical knowledge or industry experience to continue as the BSA/AML officer.”<sup>78</sup> It noted that she “was interviewed by OCC examiners from another team and they supported the conclusion of the OCC resident staff that Midzain’s knowledge and experience with BSA/AML risk is not commensurate to

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statements. She subsequently communicated via email that she does not review the annual AML statements provided to her by the HNAH/BSA/AML officer (Midzain). Burak forwards the statements to Group.” 3/25/2009 “Summary of Ratings for HSBC North America Holdings,” Federal Reserve Bank of Chicago, OCC-PSI-00899234.

<sup>74</sup> 9/13/2010 OCC Supervisory Letter HSBC-2010-22, “Bank Secrecy Act/Anti-Money Laundering (‘BSA/AML’) Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21),” OCC-PSI-00864335-365, at 27. [Sealed Exhibit.]

<sup>75</sup> Id.

<sup>76</sup> Id.

<sup>77</sup> Id. See also Federal Reserve, at BOG-A-205485.

<sup>78</sup> Federal Reserve Bank of Chicago Summary of Ratings for HSBC North America Holdings, March 25, 2009, OCC-PSI-00899234.

HNAH's BSA/AML high risk profile, especially when compared to other large national banks."<sup>79</sup>

In 2009, the OCC also concluded that Ms. Midzain did not have the requisite AML expertise for her position. An OCC Supervisory Letter echoed the criticisms leveled earlier by the Federal Reserve:

"Ms. Midzain was selected as the Compliance Director and BSA Officer although she does not have the qualifications or the experience to manage a BSA program at an institution with the size and amount of BSA compliance risk that HBUS has. She is a Canadian lawyer (a barrister and solicitor) who formerly worked for HNAH. She is also a member of Group's executive development program. ... Ms. Midzain's assignment as HBUS' BSA Officer and Compliance Director has been her first assignment outside of Canada as a part of that program. ... During its 2009 compliance management examination, the OCC determined that Ms. Midzain lacked the experience and expertise to be the BSA Officer, and the OCC included an MRA in its supervisory letter that required the bank to strengthen its BSA/AML compliance leadership by hiring a BSA Officer who is highly qualified and very experienced."<sup>80</sup>

In response to the Federal Reserve and OCC criticisms, HBUS removed Ms. Midzain from the AML post, but retained her as head of HBUS' Compliance department. In the fall of 2009, HBUS hired a new AML Director, Wyndham Clark, a former U.S. Treasury official, who assumed the post in the middle of an intensifying AML examination by the OCC and a host of serious AML problems facing the bank. Mr. Clark was required to report to Curt Cunningham, an HBUS Compliance official who freely admitted having no AML expertise,<sup>81</sup> and through him to Ms. Midzain, whom the OCC had also found to lack AML expertise. Shortly after he arrived, Mr. Clark began requesting additional resources.<sup>82</sup> After 30 days at the bank, Mr. Clark sent Mr. Cunningham a brief memorandum with his observations, noting that HBUS had an "extremely high risk business model from AML perspective," had seen recent high turnover in its AML directors, and granted only limited authority to the AML director to remedy problems:

<sup>79</sup> Id.

<sup>80</sup> 9/13/2010 OCC Supervisory Letter HSBC-2010-22, "Bank Secrecy Act/Anti-Money Laundering ('BSA/AML') Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21)," OCC-PSI-00864335-365, at 28. [Sealed Exhibit.]

<sup>81</sup> Id. at 28.

<sup>82</sup> See, e.g., 10/19/2009 email exchange between HBUS Wyndham Clark and HBUS Debra Bonosconi, "OFAC resources," OCC-PSI-00162661 (Mr. Clark commented after Janet Burak had recently approved three new compliance personnel positions, "Clearly a positive, although I understand that these were requested quite a while ago. I hope that isn't the typical response time." Ms. Bonosconi responded: "Oh, this was express time. Trust me on that. Usually the response is 'no.'").

“AML Director has the responsibility for AML compliance, but very little control over its success.  
Operate under ‘crisis’ mode, actions are reactive rather than forward thinking.  
AML Director unable to manage at high level.  
Several AML Directors/BSA Officers in a short period of time.”<sup>83</sup>

As he continued his work, Mr. Clark grew increasingly concerned that the bank was not effectively addressing its AML problems. In February 2010, Mr. Clark met with the Audit Committee of the HNAH board of directors and informed the committee that he had never seen a bank with as high of an AML risk profile as HBUS.<sup>84</sup> He also informed them that AML resources were “insufficient versus current risks and volumes,” and the bank’s systems and controls were “inconsistent with AML risk profile.”<sup>85</sup> On May 10, 2010, Mr. Clark wrote to a senior HBUS Compliance official that with regard to the bank’s AML compliance program, “With every passing day I become more concerned...if that’s even possible.”<sup>86</sup>

In July 2010, less than a year after taking the post, Mr. Clark decided to resign. He sent an email to the head of HSBC Group Compliance David Bagley explaining that he did not have the authority or support from senior compliance managers needed to do his job as AML director:

“[T]he bank has not provided me the proper authority or reporting structure that is necessary for the responsibility and liability that this position holds, thereby impairing my ability to direct and manage the AML program effectively. This has resulted in most of the critical decisions in Compliance and AML being made by senior Management who have minimal expertise in compliance, AML or our regulatory environment, or for that matter, knowledge of the bank (HBUS) where most of our AML risk resides. Until we appoint senior compliance management that have the requisite knowledge and skills in these areas, reduce our current reliance on consultants to fill our knowledge gap, and provide the AML

<sup>83</sup> 10/15/2009 HBUS memorandum from Wyndham Clark to HNAH Curt Cunningham, “30 Day Observations and Recommendations Report from AML Director,” HSBC PSI PROD 0065332.

<sup>84</sup> Subcommittee interview of Wyndham Clark (11/30/2011); 2/17/2010 “HNAH AML Program, Board Audit Committee Presentation,” by HBUS Wyndham Clark to the Audit Committee of the HNAH board of directors, HSBC OCC 3800290.

<sup>85</sup> 2/17/2010 “HNAH AML Program, Board Audit Committee Presentation,” by HBUS Wyndham Clark to the Audit Committee of the HNAH board of directors, HSBC OCC 3900290.

<sup>86</sup> 5/10/2010 email from HBUS Wyndham Clark to HBUS Anne Liddy, “AML Townhall,” OCC-PSI-00672582. See also 5/9/2010 email from HBUS Wyndham Clark to HNAH Curt Cunningham, “AML Townhall,” OCC-PSI-00672571 (“Essentially AML decisions are now being made without AML SME [subject matter expertise]. This will be very apparent to the regulators.”).

Director appropriate authority, we will continue to have limited credibility with the regulators.”<sup>87</sup>

When asked about his experience at the bank, Mr. Clark told the Subcommittee that he did not have either the authority or resources needed as AML director.<sup>88</sup> After his departure, the bank hired Gary Peterson, who was then an AML consultant to the bank, appointing him as HBUS’ new AML director.

Around the same time that Mr. Clark left the bank in 2010, Ms. Midzain also departed, leaving open the post of Chief Compliance Officer. That post remained vacant until 2011, when HBUS hired Eric Larson. He left after fifteen months on the job.<sup>89</sup> HBUS then asked Gary Peterson to serve, not only as HBUS’ AML Director, but also as its Compliance head, and as HNAH’s Regional Compliance Officer following Ms. Burak’s departure in 2010. Mr. Peterson agreed and has served in all three posts since 2010. Altogether, these personnel changes meant that, over the last five years, HBUS has had four Chief Compliance Officers and five AML Directors.

At HSBC Group, HBUS’ parent organization, for nearly ten years, from 2002 to the present, David Bagley has served as the HSBC Group’s head of Compliance. He is located in London and oversees both general and AML compliance issues. His second-in-command is Warren Leaming, Deputy Head of HSBC Group Compliance, who has been in that position since January 1, 2007. Susan Wright serves as the head of HSBC’s AML efforts. She is also located in London and has served in that position for more than a decade. John Root is a senior Group Compliance officer who has concentrated on compliance and AML issues, in part in Mexico and Latin America. Compliance personnel work with Matthew King who has served as the head of HSBC Group Audit since 2002.

## **(2) HBUS AML Program**

Federal law requires banks operating in the United States to have a minimum of four elements, an AML compliance officer in charge of the program, AML internal controls, AML training, and an independent testing of the AML program to ensure its effectiveness.<sup>90</sup> HBUS’ AML program must address a wide range of AML issues, from customer due diligence, to monitoring account and wire transfer activity, to reporting

<sup>87</sup> 7/14/2010 email from HBUS Wyndham Clark to HSBC David Bagley, OCC-PSI-00676731. Mr. Clark formally left the bank in August 2010. Subcommittee interview of Wyndham Clark (11/30/2011).

<sup>88</sup> Subcommittee interview of Wyndham Clark (11/30/2011). Mr. Clark told the Subcommittee that, prior to his leaving, the bank finally approved a number of new AML hires. Id.

<sup>89</sup> Subcommittee interview of OCC Examiner Teresa Tabor (5/17/2012).

<sup>90</sup> See 31 U.S.C. §5318(h); 12 C.F.R. §21.21.

suspicious activity to law enforcement. It must also cover a wide range of business lines and products, including Correspondent Banking, International Private Banking, Domestic Private Banking, Embassy Banking, Payment and Cash Management, and Banknotes services.

**Inadequate Staffing.** Despite its high AML risks, millions of customers, and employment of more than 16,500 employees overall, from 2006 to 2009, HBUS' entire Compliance Department numbered less than 200 full time employees; its AML Compliance staff was a subset of that and also included staff in India.<sup>91</sup> HBUS personnel told the Subcommittee that inadequate AML staffing was one of the biggest problems they faced.<sup>92</sup> OCC examinations also routinely identified inadequate staffing as a key AML problem, including with respect to unreviewed alerts,<sup>93</sup> PCM processing,<sup>94</sup> Correspondent Banking,<sup>95</sup> OFAC reviews,<sup>96</sup> Embassy Banking,<sup>97</sup> and the Compliance Review Unit that tested the bank's AML controls.<sup>98</sup>

Bank documents show that Compliance and AML staffing levels were kept low for many years as part of a cost cutting measure. In 2007, HBUS announced a "1509 Initiative" to increase the bank's return on equity by 2009, largely through cost cutting measures. One component of the plan was to ensure that 2007 and 2008 headcounts remained flat. This hiring freeze caused HBUS Compliance and the AML staffing requests to be denied or unanswered. At one point, HBUS Compliance and AML management resorted to requesting temporary staff when persistent AML alert backlogs grew to unmanageable levels. In 2007, HBUS fired its longtime AML head after she raised resource concerns with the HNAH Audit Committee; an AML director hired in 2009 left after being denied the authority and resources he considered necessary to

<sup>91</sup> Subcommittee briefing by HSBC legal counsel (6/30/2011).

<sup>92</sup> Subcommittee interview of HBUS Debra Bonosconi (11/17/2011) (Ms. Bonosconi reported to the Subcommittee that staffing was her biggest issue and that by March 2008 it was evident that more staff was needed. She made several requests for additional resources.); Subcommittee interview of HBUS Anne Liddy (2/22/2012) (Ms. Liddy made a request for resources to Carolyn Wind, but was told that there was no appetite to bring on additional staff.); Subcommittee interview of HBUS Carolyn Wind (3/7/2012); Subcommittee interview of HBUS Teresa Pesce (3/30/2012) (Ms. Pesce asked for business to provide funding for more AML Compliance positions because Compliance did not have the money.).

<sup>93</sup> 3/3/2010 OCC Supervisory Letter HSBC-2010-03, "Backlog of Monitoring Alerts and Enhanced Due Diligence Requests," OCC-PSI-00851542-545. [Sealed Exhibit.]

<sup>94</sup> 3/18/2009 OCC Supervisory Letter HSBC-2008-40, "Payment and Cash Management BSA/AML Examination," OCC-PSI-00107624-625. [Sealed Exhibit.]

<sup>95</sup> 3/3/2009 OCC Supervisory Letter HSBC-2008-34, "Correspondent Banking BSA/AML Examination," OCC-PSI-00107618-620. [Sealed Exhibit.]

<sup>96</sup> 7/28/2008 OCC memorandum, "OFAC Examination - Payment and Cash Management (PCM)," OCC-PSI-01274962; 1/20/2009 OCC Supervisory Letter HSBC-2008-41, "Office of Foreign Asset Control Examination," OCC-PSI-00000434-436. [Sealed Exhibits.]

<sup>97</sup> See 3/19/2007 OCC Supervisory Letter HSBC-2006-30, "Government and Institutional Banking BSA/AML Examination," OCC-PSI-00107567-571; 1/30/2006 OCC Supervisory Letter regarding HBUS Embassy Banking, OCC-PSI-00107529-536. [Sealed Exhibits.]

<sup>98</sup> See 6/14/2006 OCC Supervisory Letter HSBC-2006-16, "Compliance Review Unit Examination," OCC-PSI-00000341-345. [Sealed Exhibit.]

do his job. After the OCC issued its lengthy Supervisory Letter criticizing multiple aspects of HBUS' AML program, bank management began to significantly increase AML staff and resources.

**AML Staffing Problems.** In 2006, HBUS Compliance was already struggling to "handle the growing monitoring requirements" associated with the bank's correspondent banking and cash management programs, and requested additional staff.<sup>99</sup> In October 2006, HBUS Compliance officer Alan Ketley wrote that despite having very efficient processes, each month his Compliance team was "handling an average of 3,800 [alerts] per person and [was] becoming overwhelmed thus potentially placing the business and the bank at risk."<sup>100</sup> Despite requests for additional AML staffing, HBUS decided to hold staff levels to a flat headcount.<sup>101</sup>

**1509 Initiative and Hiring Freeze.** In 2007, against the backdrop of losses stemming from its troubled acquisition of Household International and the beginning of the global financial crisis, HBUS launched the 1509 Initiative which sought to achieve a 15% return on equity for the bank by 2009, primarily by cutting costs. One facet of the 1509 Initiative was the "\$100 Million Dollar Cost Challenge," which set a goal of cutting costs of \$100 million in 2007.<sup>102</sup>

The hiring freeze began in September 2007, when HBUS Compliance had a headcount of 198 full time employees, one below its December 2006 level.<sup>103</sup> When Compliance sought to fill six open positions, David Dew, HBUS Chief Operating Officer (COO), informed Compliance head and AML director Carolyn Wind that the positions could not be filled:

"This increase will be almost impossible to justify and therefore I must ask you to please cancel the open positions and ensure that your FTE as at 31 Dec 2007 does not exceed 199."<sup>104</sup>

To make the case for increased staffing resources, in September 2007, HBUS Compliance personnel reached out to compliance peers at

<sup>99</sup> See 10/31/2006 email from HBUS Alan Ketley to HBUS Michael Gallagher, Denise Reilly, and Charles DelBusto, "Additional Compliance headcount needed to support PCM," HSBC OCC 0616340-43, at 341.

<sup>100</sup> Id. at HSBC OCC 0616342.

<sup>101</sup> See, e.g., 10/31/2006 email exchange between HBUS Michael Gallagher and HBUS Tony Murphy, Charles DelBusto, Alan Ketley, and others, "Additional Compliance headcount needed to support PCM," HSBC OCC 0616340-343; 9/25/2006 email exchange between HBUS Michael Gallagher and HBUS Teresa Pesce, Alan Ketley, Charles DelBusto, and others, "Additional monitoring resources," HSBC OCC 7688655-657.

<sup>102</sup> See HSBC internal presentation entitled, "1509," HSBC OCC 06162241-242.

<sup>103</sup> 9/14/2007 email from HBUS David Dew to HBUS Carolyn Wind, Janet Burak, and Kathryn Hatem, "HEADCOUNT," HSBC OCC 0616262.

<sup>104</sup> Id.

other banks and learned that at the three major banks that provided some information, each had a greater number of monitoring staff in the correspondent banking area than HBUS.<sup>105</sup> In addition, HBUS Compliance personnel noted that HBUS Compliance filed many fewer Suspicious Activity Reports (SARs) than its competitors;<sup>106</sup> while HBUS filed three to four per month in the correspondent banking area, its peers filed 30 to 75 per month, and one major international bank disclosed that it filed approximately 250 SARs per month.<sup>107</sup> Despite these statistics, the Compliance department and AML staff remained stagnant.

**Fired After Raising Staffing Concerns to Board.** After being turned down for additional staff, Carolyn Wind, longtime HBUS Compliance head and AML director, raised the issue of inadequate resources with the HNAH board of directors. A month after that board meeting, Ms. Wind was fired.

On October 24, 2007, Ms. Wind met with the Audit Committee of the HNAH board of directors and, during the meeting, raised the staffing issue, particularly with respect to the Embassy Banking area which had been the subject of two recent OCC examinations uncovering severe AML deficiencies. Her supervisor, Regional Compliance Officer Janet Burak, also attended the Audit Committee meeting. The day after the meeting, in an email to HSBC Group Compliance head David Bagley, Ms. Burak expressed displeasure that Ms. Wind's comments had caused "inappropriate concern" at the Audit Committee:

"I indicated to her [Ms. Wind] my strong concerns about her ability to do the job I need her to do, particularly in light of the comments made by her at yesterday's audit committee meeting .... I noted that her

<sup>105</sup> On 9/6/2007, Mr. Ketley wrote: "Every bank that responded and provided information about monitoring staff has more than HBUS." 9/6/2007 email from HBUS Alan Ketley to HBUS Alan Williamson, Judy Stoldt, and George Tsugranes, "Correspondent survey," HSBC OCC 0616384-385. See also 9/6/2007 HBUS chart, "Correspondent Banking Survey," HSBC OCC 3400666. [Sealed Exhibit.] See also emails indicating HBUS Compliance personnel were not compensated at levels consistent with its competitors, and risked losing qualified personnel. See, e.g., 2/1/2007 email exchange among HBUS Carolyn Wind, HBUS Teresa Pesce and others, "MIP overages - URGENT," HSBC OCC 0616314-316, at 314 ("We are not at market with our current comp[ensation]") and "[t]hese officers and AML officers can get new jobs in a heartbeat"); 2/27/2007 email from HBUS Karen Grom to HBUS Carolyn Wind, Denise Reilly, Teresa Pesce, David Dew and others, "HUSI Compensation Review," HSBC OCC 0616318 ("The banks who are approaching our employees have deep pockets and are willing to pay to get the talent. ... In many cases, we are paying under the 'market data point' (50<sup>th</sup> percentile).") and "The offers from head-hunters are in some cases double base salaries and double bonuses[.].").  
<sup>106</sup> 9/6/2007 email from HBUS Alan Ketley to HBUS Alan Williamson, Judy Stoldt, and George Tsugranes, "Correspondent survey," HSBC OCC 0616384-385 (Mr. Ketley wrote: "Our competitors all acknowledge filing more SARs than we do."); 9/6/2007 HBUS chart, "Correspondent Banking Survey," HSBC OCC 3400666. [Sealed Exhibit.]

<sup>107</sup> 8/27/2007 email from HBUS Alan Ketley to HBUS Michael Gallagher, Charles DelBusto, Chris Davies, and Alan Williamson, "Addressing negative information," HSBC OCC 7688584-587, at 587.

comments caused inappropriate concern with the committee around: our willingness to pay as necessary to staff critical compliance functions (specifically embassy banking AML support), and the position of the OCC with respect to the merger of AML and general Compliance.”<sup>108</sup>

A month after the board meeting, after seven years as HBUS’ Compliance head, Ms. Wind was notified that she was being fired. In a January 22, 2008 letter to the head of HBUS Human Resources, Ms. Wind wrote:

“I was told on November 30, 2007 that I was being terminated effective 2/28/08, due to the fact that the Board had lost confidence in me. ... If the Board has lost confidence in me based on my comments at the October, 2007 Audit Committee, why have I been allowed to continue to run this critical department without additional supervision or any direct follow-up from Group Compliance?”

Ms. Wind also wrote: “David [Dew] and I disagree on the extent to which my organization can withstand cost cuts and still maintain an effective compliance risk mitigation program. I also believe in an open dialog with the Board and its committees, which may go against the desires of some in the organization.”<sup>109</sup> When asked about this document, Ms. Wind told the Subcommittee that she believed she was fired for telling the HNAH board about the need for additional Compliance resources.<sup>110</sup>

**Hiring Freeze Continues.** After her departure, the hiring freeze continued throughout 2008.<sup>111</sup> In February 2008, prior to her leaving the bank, Ms. Wind discussed the staffing freeze with HNAH COO Anthony Gibbs:

“HBUS Compliance has been required to manage down overall FTE [full time employees] while at the same time redeploying resources to priority needs. We also are in the midst of a ‘hiring pause’ which means that approval from appropriate EXCO members is required to fill any open position. I do not expect a lot

<sup>108</sup> 10/25/2007 email from Janet Burak to David Bagley, OCC-PSI-00704789.

<sup>109</sup> January 22, 2008 letter from Carolyn Wind to Jeanne Ebersole, HSBC OCC 7730334.

<sup>110</sup> Subcommittee interview of Carolyn Wind (3/07/2012). Anne Liddy also reported that Ms. Wind told her in 2007 that she had been terminated due to Ms. Wind raising resource concerns to the board’s audit committee. Subcommittee interview of Anne Liddy (2/22/2010). Also see, Minutes of the Audit Committee Meeting, October 24, 2007, HSBC OCC 3516806.

<sup>111</sup> On 1/17/08, Jeanne Ebersole, Executive Vice President HBUS Human Resources, wrote to the HBUS Executive Committee [EXCO], “Attached is a draft of the non-hiring freeze note to be sent to all GCBs 0, 1, 2 and the final headcount report for 2007 which we will discuss tomorrow at EXCO.” 1/17/2008 email from HBUS Jeanne Ebersole to HBUS Chris Davies, David Dew, Janet Burak and others, “Draft Materials for EXCO,” HSBC OCC 0616259-260, at 259.



of support for overall HBUS Compliance headcount increasing even if a portion of the time is allocated to other affiliates.”<sup>112</sup>

In June 2008, a senior PCM operations manager emailed senior HBUS Compliance official Anne Liddy about growing backlogs in the OFAC Compliance program:

“I have put forth the suggestion of hiring up some first level checkers for OFAC processing in the GSC...we’re strapped and getting behind in investigations (on OFAC cases) and have some of our key managers in the queues releasing items... I’m told I cannot hire first level staff unless it’s offshored...”<sup>113</sup>

An OCC examination later found that eight Compliance officers were under “rigorous pressure” to complete manual reviews of about 30,000 OFAC alerts per week.<sup>114</sup>

In July 2008, however, HSBC Group senior management determined that the hiring freeze would continue to the end of the year. CEO Michael Geoghegan wrote to HNAH CEO Brendan McDonagh and others: “We have agreed that we will have a headcount freeze until the end of the year.”<sup>115</sup>

HBUS Compliance personnel, with the support of their business units, attempted to obtain an exception to the hiring freeze. In a September 2008 email, Michael Gallagher, PCM head at HBUS, requested additional Compliance staff, explaining: “I have expressed considerable concern for some time over the lack of resources both in compliance and within pcm [Payments and Cash Management] to adequately support kyc [Know Your Customer] and related regulatory requirements.”<sup>116</sup> Lesley Midzain, then HBUS Chief Compliance Officer, echoed his concerns and requested four additional full time employees:

“Given the hiring freeze in global businesses, I understand that it may also need approval by Paul Lawrence, but this has continued

<sup>112</sup> 2/12/2008 email from HBUS Carolyn Wind to HBUS Anthony Gibbs, Curt Cunningham, Denise Reilly and others, “Organizational Changes,” HSBC OCC 0616264.

<sup>113</sup> See 6/19/2008 email exchanges among HBUS Anne Liddy and HBUS Nancy Hedges, “OFAC processing in GSC’s,” HSBC OCC 0616349-350, at 349.

<sup>114</sup> 7/28/2008 OCC memorandum, “OFAC Examination – Payment and Cash Management (PCM),” OCC-PSI-01274962 (“the bank’s Compliance teams are under rigorous pressure to process alerts and determin[e] a disposition in a timely manner”). [Sealed Exhibit.]

<sup>115</sup> 7/23/2008 email from HSBC Michael Geoghegan to HNAH Brendan McDonagh and others, “2nd Half Costs,” OCC-PSI-00727922.

<sup>116</sup> See 9/4/2008 email exchanges among HBUS Michael Gallagher and HBUS David Dew, Lesley Midzain, Andrew Long, Chris Davies and others, “Kyc hires,” HSBC OCC 0616352-356, at 356. When asked about this document, Mr. Gallagher said that Mr. Dew had informed him that broader concerns in the U.S. and at Group necessitated a flat headcount. Subcommittee interview of Michael Gallagher (6/13/2012).

to be an area of notable risk and regulatory attention and which needs some stabilization for Compliance resources.”<sup>117</sup>

After expressing concern over how additional hires would impact operating expenses, Mr. Dew, HBUS COO, asked Ms. Midzain if “a couple of temps for two months” would “do the trick.”<sup>118</sup>

Hiring did not improve during 2009. Wyndham Clark, who had been hired in 2009, as the new HBUS AML director, noted in an email that Janet Burak had recently approved three new compliance positions. He wrote: “Clearly a positive, although I understand that these were requested quite a while ago. I hope that isn’t the typical response time.” A senior PCM operations officer responded: “Oh, this was express time. Trust me on that. Usually the response is ‘no.’”<sup>119</sup> The Subcommittee was told that in September 2009, the HBUS Compliance department had 130 full time employees handling AML compliance issues.<sup>120</sup>

**OCC Examination.** During late 2009 and the first half of 2010, the OCC expanded and intensified its examination of the bank’s AML program as a whole. Mr. Clark made increasing use of temporary employees and contractors to answer OCC inquiries and address AML deficiencies. In August, he left the bank. By then, he was using nearly 100 temporary employees and contractors and had requested 50 additional permanent full time Compliance personnel.<sup>121</sup> Even with those additional resources, the OCC’s September 2010 Supervisory Letter identifying AML deficiencies at the bank criticized HBUS’ failure “to provide adequate staffing and resources to implement and maintain a BSA/AML compliance program commensurate with the bank’s high risk profile.”<sup>122</sup> The OCC Supervisory Letter also noted: “Management is still in the process of determining an appropriate level of resources as they consider recommendations from outside consultants and make strategic decisions about the business and risk on a prospective basis.”<sup>123</sup> By October 2010, the Compliance department had increased to over 400 full time employees.<sup>124</sup>

**AML Monitoring Deficiencies.** In addition to AML leadership problems and inadequate AML staffing, another key component of HBUS’ AML program involved its monitoring systems. During the

<sup>117</sup> Id. at HSBC OCC 0616354.

<sup>118</sup> Id. at HSBC OCC 0616352.

<sup>119</sup> 10/19/2009 email exchange between HBUS Wyndham Clark and HBUS Debra Bonosconi, “OFAC resources,” OCC-PSI-00162661.

<sup>120</sup> Subcommittee briefing by HSBC legal counsel (6/30/2011).

<sup>121</sup> 9/13/2010 OCC Supervisory Letter HSBC-2010-22, “Bank Secrecy Act/Anti-Money Laundering (‘BSA/AML’) Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21),” OCC-PSI-00864335-365, at 29. [Sealed Exhibit.]

<sup>122</sup> Id.

<sup>123</sup> Id.

<sup>124</sup> Subcommittee briefing by HSBC and HBUS executives (6/26/2012).

period reviewed by the Subcommittee, dating from 2004, HBUS used a monitoring system called the Customer Activity Monitoring Program (CAMP). This system had many limitations and often required manual reviews by HBUS Compliance and AML staff.

By 2006, as indicated earlier, HBUS Compliance was already struggling to handle the monitoring alerts generated by the bank's growing correspondent banking and cash management programs and described its personnel as "becoming overwhelmed."<sup>125</sup> Backlogs of unreviewed alerts in different areas of the bank began to accumulate, including with respect to alerts generated by CAMP monitoring of client accounts and wire transfer activity; alerts triggered by the OFAC filter on transactions by potentially prohibited persons identified on OFAC lists of terrorists, drug traffickers, and other wrongdoers; and alerts related to potentially suspicious activity in Embassy Banking accounts.

With respect to the general CAMP system alerts for PCM, HBUS Compliance set a goal that no more than 2% of AML alerts should remain in the system for over 120 days without being resolved. In addition, the system notified increasingly senior management if the backlog exceeded certain thresholds. For example, when the CAMP alerts hit 3%, bank compliance officials like Anne Liddy were alerted; when it hit 4%, higher level compliance personnel such as AML director Lesley Midzain were notified; if the backlog hit 6%, HNAH's Regional Compliance Officer Janet Burak was notified.<sup>126</sup> In November 2009, the percentage of AML alerts in the system for longer than 120 days spiked from 4% in October to 9%.<sup>127</sup> The backlog remained at 9 or 10% for the next four months, from December 2010 to February 2010, and then stayed around 6 or 7% from March to May 2010.<sup>128</sup> In early 2010, as part of its expanded AML examination, the OCC discovered the CAMP backlog of more than 17,000 unreviewed alerts as well as a backlog of requests for enhanced due diligence (EDD) reviews.<sup>129</sup> On March 3, 2010, an OCC Supervisory Letter ordered the bank to eliminate the alert and EDD backlog by June 30, 2010.<sup>130</sup> The bank met the deadline using "offshore reviewers in India, HBUS staff in Delaware, HBUS temporary volunteers, [and] outside contractors."<sup>131</sup> A subsequent review by the

<sup>125</sup> See 10/31/2006 email from HBUS Alan Ketley to HBUS Michael Gallagher, Denise Reilly, and Charles DelBusto, "Additional Compliance headcount needed to support PCM," HSBC OCC 0616340-43, at 342.

<sup>126</sup> "Bankwide KRI AML Transaction Monitoring Alert Aging - K02854," HSBC OCC 7688689.

<sup>127</sup> Id.

<sup>128</sup> Id.

<sup>129</sup> 3/3/2010 OCC Supervisory Letter HSBC-2010-03, "Backlog of Monitoring Alerts and Enhanced Due Diligence Requests," OCC-PSI-00851542. [Sealed Exhibit.]

<sup>130</sup> Id.

<sup>131</sup> 9/13/2010 OCC Supervisory Letter HSBC-2010-22, "Bank Secrecy Act/Anti-Money Laundering ('BSA/AML') Examination - Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21)," OCC-PSI-00864335-365, at 9. [Sealed Exhibit.]

OCC, however, found “deficiencies in the quality of the work,” and required an independent assessment.<sup>132</sup> The independent assessment found that 34% of the alerts supposedly resolved had to be re-done.

As Ms. Wind reported to the board in October 2007, backlogs were also an issue in Embassy Banking. A 2008 OCC examination identified a backlog of over 3,000 alerts identifying potentially suspicious activity in Embassy accounts that had yet to be reviewed.<sup>133</sup> In response, HBUS initiated a concentrated effort to review and resolve those alerts prior to a followup OCC examination in July 2008.<sup>134</sup> The followup examination found a backlog of about 1,800 alerts, some of which dated from 2007. The OCC examiners recommended issuance of a Cease and Desist Order to the bank in part due to the backlog, but the OCC instead issued a Supervisory Letter, identified the backlog as a Matter Requiring Attention by the bank, and required the backlog to be cleared by September 15, 2008.<sup>135</sup> The bank met that deadline.<sup>136</sup>

A third category of alert backlog involved transactions that were stopped by the OFAC filter as possible violations of OFAC regulations. Each transaction had to be manually reviewed and resolved by two 4-person OFAC Compliance teams in New York and Delaware. In July 2007, HSBC introduced a new payment system, GPS, in the United States.<sup>137</sup> The system had undergone several adjustments just prior to its launch, including changes to its OFAC filters, which caused unexpectedly large backlogs.<sup>138</sup> HBUS assigned a team to assist with clearing the backlog, but the problem still took weeks to resolve.

<sup>132</sup> Id.

<sup>133</sup> 8/14/2008 OCC memorandum, “Government and Institutional Banking Update,” OCC-PSI-00899227-233, at 231. [Sealed Exhibit.]

<sup>134</sup> July 31, 2008 Memorandum from HBUS Debra Bonosconi to HBUS David Dew, Lesley Midzain, and Cam Hughes. OCC-PSI-00409095. Also see 7/14/2008 Memorandum from HBUS Debra Bonosconi to HBUS David Dew, Lesley Midzain, Cam Hughes (“As shown in the chart below, we currently (as of 7/15) have a total of 1,793 open alerts which is a reduction of 1,519 from 3,312 on June 27<sup>th</sup>. There are a total of 203 that are open in excess of 120 days and 147 open in excess of 90 days (350 combined) and we are concentrating our efforts on reducing those first. We are closing an average of 84 alerts daily (including Saturday) and based upon current projections, we should have total of 1,499 pending alerts when the OCC arrives on July 21, 2008.”), OCC-PSI-00285742

<sup>135</sup> See 9/4/2008 OCC Supervisory Letter HSBC-2008-07, “Government and Institutional Banking BSA/AML Examination,” OCC-PSI-00107607-611. [Sealed Exhibit.]

<sup>136</sup> 9/13/2010 OCC Supervisory Letter HSBC-2010-22, “Bank Secrecy Act/Anti-Money Laundering (“BSA/AML”) Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21),” OCC-PSI-00864335-365, at 9. [Sealed Exhibit.]

<sup>137</sup> See, e.g., 7/29/2007 email from HBUS Andrew Long to HBUS Michael Gallagher, “draft strawman,” HSBC OCC 7688680-682; 7/18/2007 email from HBUS Carolyn Wind to HBUS William Johnson, David Dew, Michael Gallagher, Andrew Long, David Bagley and others, “HBUS GPS Day 2 and 3 Update,” HSBC OCC 7688676-678, at 677.

<sup>138</sup> Id.

In December 2009, HBUS' OFAC Compliance team in New York had accumulated a backlog of greater than 700 OFAC alerts.<sup>139</sup> The OFAC Compliance team requested five or six people from PCM for ten days to help clear the backlog.<sup>140</sup> PCM responded that it had no resources to loan, and suggested asking the Compliance team in Delaware for help. The OFAC Compliance team in New York indicated the Delaware Compliance staff was already "fully deployed" dealing with general alerts from the CAMP monitoring system:

"We have considered all options at this point[;] the Compliance team in DE is already fully deployed dealing with wire camp alerts and bank examiner requests for the current exam. There is no bandwidth there at all[;] they are behind on the current alert clearing process which we are also dealing with."<sup>141</sup>

Understaffed, HBUS Compliance and AML staff constantly battled alert backlogs while requesting additional resources. These requests, if answered, generally resulted in additional temporary staff dispatched only when backlogs grew to unmanageable levels. As the backlog increased, tensions grew, and in February 2010, Mr. Clark, the AML Director who had been on the job only a few months, wrote: "[W]e are in dire straights [sic] right now over backlogs, and decisions being made by those that don't understand the risks or consequences of their decisions!!!!"<sup>142</sup>

The problems with HBUS' AML monitoring system were not limited to the backlogs. Additional issues involved an array of problematic decisions on what clients and countries should be designated high risk and subject to enhanced monitoring; what accounts and wire transfer activity should be subject to or excluded from routine AML monitoring; what parameters should be used to trigger alerts, including dollar thresholds, key words or phrases, and scenario rules that combine specified elements; and what "negative rules" should be used to decrease the number of alerts that would otherwise be generated for

<sup>139</sup> 12/11/2009 email exchange among HBUS Camillus Hughes and HBUS Michael Gallagher, Charles DelBusto, Sandra Peterson, Thomas Halpin, Chris Davies, and Lesley Midzain, "OFAC Payments," HSBC OCC 7688668-670, at 670.

<sup>140</sup> Id.

<sup>141</sup> Id. at HSBC OCC 7688668.

<sup>142</sup> 2/26/2010 email from HBUS Wyndham Clark to HBUS Debra Bonosconi, OCC-PSI-00165898. In another email the next day, Mr. Clark wrote: "At this point the businesses are not accepting that they own the risk, I can think of one exception, making the difficult decisions and taking the necessary steps to mitigate the risk. My view is the risks are being ignored by the business, and they are simply waiting for compliance to tell them what the risks are and to convince them as to what actions need to be taken. If they don't know what the risks are, then why are they opening accounts or continuing with the relationship?" On the same day, Anne Liddy responded: "[W]e spend a lot of energy pushing our point and holding our ground and certainly Group member referred relationships/transactions have increased our HBUS risk." 2/27/2010 email exchange between HBUS Anne Liddy, Wyndham Clark, and Debra Bonosconi, OCC-PSI-00165932.

review.<sup>143</sup> The OCC's September 2010 Supervisory Letter identified multiple problems with each of these elements of HBUS' AML monitoring systems.<sup>144</sup>

**Current Status of HBUS AML Program.** In the two years since the OCC issued its September 2010 Supervisory Letter and both the OCC and Federal Reserve issued October 2010 Cease and Desist Orders to HBUS and HNAH regarding the many AML deficiencies in their programs, both HBUS and HNAH, as well as HSBC, have made commitments to strengthen their AML programs, including by directing more resources to compliance needs. HBUS told the Subcommittee that Gary Peterson will remain as its Compliance head, and his deputy will take over the duties of AML director, to ensure both positions have a full time executive.<sup>145</sup> HBUS also informed the Subcommittee that as of July 2012, it had increased its Compliance and AML staff to over 1,000 full time employees.<sup>146</sup> It is also in the process of replacing CAMP with an improved AML monitoring system, NORKOM. Additional reforms include scaling back its correspondent banking and embassy banking relationships by closing higher risk accounts, as well as closing its banknotes business in 2010.<sup>147</sup> With respect to HSBC affiliates, HBUS told the Subcommittee it has initiated due diligence reviews of all such affiliates to identify those that are high risk, enabled all affiliates to obtain internal audit findings and other information to improve affiliate risk assessments, ended any limits on the monitoring of affiliates, and increased affiliate information sharing to strengthen AML compliance.<sup>148</sup>

In addition, on April 30, 2012, HSBC Group issued a new Group Circular Letter (GCL) 120014, announcing the intention of the bank to use the highest global compliance standards for every HSBC affiliate. The HSBC GCL stated:

“We must adopt and enforce the adherence to a single standard globally that is determined by the highest standard we must apply anywhere. Often, this will mean adhering globally to U.S. regulatory standards, but to the extent another jurisdiction requires

<sup>143</sup> See 9/13/2010 OCC Supervisory Letter HSBC-2010-22, “Bank Secrecy Act/Anti-Money Laundering (‘BSA/AML’) Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21),” OCC-PSI-00864335-365, at 10-21. [Sealed Exhibit.]

<sup>144</sup> Id.

<sup>145</sup> Subcommittee briefing by HSBC and HBUS executives (6/26/2012).

<sup>146</sup> Id. See also, 7/10/2012 HSBC Group News, “HSBC to Testify at U.S. Senate Hearing,” letter by HSBC Group Chief Executive Stuart Gulliver, PSI-HSBC-76-0001-002, at 002.

<sup>147</sup> As of June 2012, HBUS had closed all banknotes accounts, 24 embassy accounts, and 326 correspondent relationships. In August 2010, as part of this review to exit relationships, HBUS CEO Irene Dörner noted that she was recommending closing relationships with 121 international banks that “do not meet either risk or return hurdles.” 9/20/2010 email from Irene Dörner to Andrew Long and others, HSBC OCC 8876104-106.

<sup>148</sup> Subcommittee briefing by HSBC and HBUS executives (6/26/2012).

higher standards, then that jurisdiction's requirements must shape our global standard."<sup>149</sup>

This new GCL could represent a groundbreaking approach for the bank if it, in fact, pushes its affiliates toward uniform and high compliance standards.

These reforms, like those announced in 2004 after the bank's last AML enforcement action, have the potential to resolve the AML deficiencies at the bank and push HBUS to an improved level of AML compliance. While HBUS has committed to making major changes, the bank made similar commitments under the 2003 enforcement action, which the OCC lifted in 2006, after which the bank's AML program quickly deteriorated. On many occasions since then, HBUS responded to AML problems identified by the OCC by instituting new policies and procedures that appeared to be effective remedies. However, it has often been the case that regulators would subsequently cite HBUS for failing to comply with its own policies and procedures. In 2006, for example, when the OCC lifted the AML enforcement action, HBUS had already incurred over 30 AML-related Matters Requiring Attention, many of which cited AML problems similar to those that had formed the basis of the written agreement.

In addition, not all of the AML reforms proposed since 2010 have proceeded smoothly. The new compliance head hired by the bank left after fifteen months. The bank's new monitoring system has been the subject of OCC criticisms aimed at whether its monitoring parameters have been correctly set to identify suspicious activity and provide adequate AML oversight of client account and wire transfer activity.<sup>150</sup> While the recent GCL could represent an important advance in requiring bank affiliates to adhere to the highest AML standards globally, as this report documents, it can take months, if not years, for HSBC affiliates to come into compliance with HSBC GCL directives. The burden of proof is on HSBC Group to show that its latest directive is taking hold and its affiliates are complying with the highest AML stands, and on HBUS to show that it is moving from an ineffective AML program to one that safeguards the U.S. financial system from abuse.

<sup>149</sup> GCL 120014 – HSBC Global Standards.

<sup>150</sup> See 5/25/2012 OCC Supervisory Letter HSBC-2012-19, "Payments and Cash Management (PCM); Bank Secrecy Act and Anti-Money Laundering (BSA/AML) System Examination," PSI-OCC-37-0004. [Sealed Exhibit.] See also 6/25/2012 HSBC response letter, Supervisory Letter HSBC 2012-19 "Payments and Cash Management (PCM); Bank Secrecy Act and Anti-Money Laundering (BSA/AML) System Examination," HSBC-PSI-PROD-0200315-341. [Sealed Exhibit.]

### III. HBMX: PROVIDING U.S. ACCESS TO A HIGH RISK AFFILIATE

HBUS has opened correspondent accounts for approximately 80 HSBC affiliates around the world, providing them with access to the U.S. financial system through clearing U.S. dollar wire transfers, cashing U.S. dollar checks, buying and selling physical U.S. dollars, and other services.<sup>151</sup> Some of those HSBC affiliates operate in high risk countries, provide services to high risk clients, or offer high risk financial products. Until recently, HSBC Group policy, however, allowed its affiliates to assume that any HSBC affiliate owned 50% or more by the Group met Group AML standards, were low risk, and required no due diligence prior to opening a correspondent account.<sup>152</sup> In conformance with that HSBC Group policy, for years, HBUS did not conduct any due diligence analysis or risk assessment of an HSBC affiliate prior to supplying it with a U.S. account. HBUS took that approach, even though U.S. statutory and regulatory requirements explicitly direct U.S. banks to conduct due diligence prior to opening a correspondent account for any foreign financial institution, with no exception for foreign affiliates.<sup>153</sup>

HBMX, an HSBC affiliate in Mexico, illustrates how providing a correspondent account and U.S. dollar services to a high risk affiliate increased AML risks for HBUS. HBMX was created when HSBC Group purchased a Mexican bank known as Bital in 2002. A pre-purchase review disclosed that the bank had no functioning compliance program, despite operating in a country confronting both drug trafficking and money laundering. For years, HSBC Group knew that HBMX continued to operate with multiple AML deficiencies while serving high risk clients and selling high risk products. HSBC Group also knew that HBMX had an extensive correspondent relationship with

<sup>151</sup> As of February 2010, HBUS had about 2,400 clients in its Payments and Cash Management (PCM) department. See 9/13/2010 OCC Supervisory Letter HSBC-2010-22, "Bank Secrecy Act/Anti-Money Laundering ('BSA/AML') Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21)," OCC-PSI-00864335-365, at 7. [Sealed Exhibit.] In June 2012, HBUS had a total of nearly 1,200 correspondent clients, of which 80 were HSBC affiliates. The HSBC affiliates had 395 HBUS accounts, of which 7 or 8 related to HBMX. Subcommittee briefing by HSBC legal counsel (6/20/2012).

<sup>152</sup> See, e.g., 4/9/2010 memorandum from OCC legal counsel to OCC Washington Supervision Review Committee, "Order of Investigation – HSBC Bank USA, N.A., New York, NY," OCC-PSI-00899482-485, at 2 (citing HBUS's 12/1/2008 AML Procedures Manual at 12: "The only exception to the KYC Profile requirement is any client who is an HSBC Group affiliate in which HSBC has an ownership interest of 50% or more."). After the September 2010 OCC Supervisory Letter criticizing its practice, HSBC Group changed its policy and now requires all affiliates to perform due diligence on all other affiliates.

<sup>153</sup> See, e.g., 4/9/2010 memorandum from OCC legal counsel to OCC Washington Supervision Review Committee, "Order of Investigation – HSBC Bank USA, N.A., New York, NY," OCC-PSI-00899482-485, at 2 ("The Bank is obligated to conduct due diligence, and, where necessary, EDD [Enhanced Due Diligence], on foreign correspondent accounts. 31 U.S.C. § 5318(i)(1). ... Section 5318(i) does not exempt foreign correspondent accounts that a bank maintains for its affiliates.").



HBUS and that suspect funds moved through the HBMX account, but failed to inform HBUS of the extent of the AML problems at HBMX so that HBUS could treat HBMX as a high risk account. Instead, until 2009, HBUS treated HBMX as low risk.

Contrary to its designation, HBMX engaged in many high risk activities. It opened accounts for high risk clients, including Mexican casas de cambio and U.S. money service businesses, such as Casa de Cambio Puebla and Sigue Corporation which later legal proceedings showed had been used on occasion, from 2005 to 2007 for Puebla and from 2003 to 2005 for Sigue, to launder funds from illegal drug sales in the United States. HBMX also offered high risk products, including providing U.S. dollar accounts in the Cayman Islands to nearly 50,000 clients with \$2.1 billion in assets, many of which supplied no KYC information and some of which misused their accounts on behalf of a drug cartel. HBMX was also the single largest exporter of U.S. dollars to HBUS, transferring over \$3 billion in 2007 and \$4 billion in 2008, amounts that far outstripped larger Mexican banks and other HSBC affiliates. Mexican and U.S. law enforcement and regulatory authorities expressed concern that HBMX's bulk cash shipments could reach that volume only if they included illegal drug proceeds that had been brought back to Mexico from the United States. In addition, for a three-year period from mid-2006 to mid-2009, HBUS failed to conduct any AML monitoring of its U.S. dollar transactions with HSBC affiliates, including HBMX, which meant that it made no effort to identify any suspicious activity, despite the inherent risks in large cash transactions.<sup>154</sup>

HBMX conducted these high risk activities using U.S. dollar correspondent and banknotes accounts supplied by HBUS. HBMX used those accounts to process U.S. dollar wire transfers, clear bulk U.S. dollar travelers cheques, and accept and make deposits of bulk cash, all of which exposed, not only itself, but also HBUS, to substantial money laundering risks. HBMX compounded the risks through widespread, weak AML controls, while HBUS magnified them by omitting the due diligence and account monitoring it applied to other accounts. HSBC Group also compounded the AML risks by failing to alert HBUS to HBMX's ongoing, severe AML deficiencies.

#### **A. HSBC Mexico**

In November 2002, HSBC Group purchased Mexico's fifth largest bank, Banco Internacional, S.A., then part of Grupo Financiero Bital,

<sup>154</sup> See 9/13/2010 OCC Supervisory Letter HSBC 2010-22, OCC-PSI-00000230, at 2. [Sealed Exhibit.]

S.A. de C.V. (Bital), for about \$1.1 billion.<sup>155</sup> At the time of the purchase, Bital had roughly 6 million customers and 15,400 staff.<sup>156</sup> This acquisition significantly increased HSBC's banking presence in Mexico.<sup>157</sup> HSBC later changed the name of the bank to HSBC Mexico S.A. Banco (HBMX) and the name of the holding company to Grupo Financiero HSBC, S.A. de C.V. (GF HSBC). GF HSBC is now one of Mexico's largest financial service conglomerates, owning not only HBMX but also a network of other financial firms.<sup>158</sup> HBMX currently has over 1,100 branches, \$2 billion in assets, and over 8 million clients.<sup>159</sup> HBMX and its Mexican parent are headquartered in Mexico City and together have over 19,000 employees.<sup>160</sup> HSBC typically refers to its Mexican operations as HSBC Mexico.

Since the purchase of Bital, three persons have served as the head of HSBC Mexico. The first was Alexander (Sandy) Flockhart who served as Chairman and Chief Executive Officer (CEO) of HBMX, and later also as CEO of HSBC's Latin America operations, from 2002 to 2007.<sup>161</sup> After he was made Latin American regional head,<sup>162</sup> Paul Thurston took the post of HSBC Mexico CEO and later also served as the HSBC Latin America CEO.<sup>163</sup> Mr. Thurston headed the Mexico operations for just over a year, from February 2007 to May 2008. When

<sup>155</sup> See "HSBC Consuma la Adquisición de GF BITAL," (11/25/02), [http://www.hsbc.com.mx/1/PA\\_1\\_1\\_S5/content/home\\_en/investor\\_relations/press\\_releases/infpr ess/hsbc\\_consuma.pdf](http://www.hsbc.com.mx/1/PA_1_1_S5/content/home_en/investor_relations/press_releases/infpr ess/hsbc_consuma.pdf); "HSBC Buys Mexican Bank Bital," CNN.com (8/25/2002), <http://archives.cnn.com/2002/BUSINESS/asia/08/21/uk.hsbc>.

<sup>156</sup> 8/21/2002 "HSBC agrees to acquire Grupo Financiero Bital," HSBC press release, <http://www.hsbc.com/1/2/newsroom/news/2002/hsbc-agrees-to-acquire-grupo-financiero-bital>.

<sup>157</sup> Two years earlier, in 2000, HSBC had acquired a smaller bank in Mexico, Republic National Bank of New York (Mexico) S.A. See 10/21/2011 "Doing Business in Mexico," HSBC publication, at 34, [http://www.hsbc.com/1/content/assets/business\\_banking/111021\\_doing\\_business\\_in\\_mexico.pdf](http://www.hsbc.com/1/content/assets/business_banking/111021_doing_business_in_mexico.pdf)

<sup>158</sup> Among other entities, GF HSBC owns a securities firm, insurance company, and pension fund. See HSBC Mexico website, "Grupo HSBC Mexico," <http://www.hsbc.com.mx/1/2/grupo>. Former HBMX head Paul Thurston told the Subcommittee that HBMX experienced rapid growth from its purchase in 2002. Subcommittee interview of Paul Thurston (5/1/2012).

<sup>159</sup> See 10/21/2011 "Doing Business in Mexico," HSBC publication, at 6, [http://www.hsbc.com/1/content/assets/business\\_banking/111021\\_doing\\_business\\_in\\_mexico.pdf](http://www.hsbc.com/1/content/assets/business_banking/111021_doing_business_in_mexico.pdf)

; "Grupo HSBC México," HSBC website, <http://www.hsbc.com.mx/1/2/grupo>.

<sup>160</sup> See HSBC website, Grupo HSBC México, <http://www.hsbc.com.mx/1/2/grupo>, viewed 4/2/12.

<sup>161</sup> He was Group General Manager, Chairman and Chief Executive Officer of HBMX from 2002 to 2006, and Group Managing Director Latin America from 2006 to July 2007. See his biography on the HSBC website, [http://www.hsbc.com/1/PA\\_esf-ca-app-content/content/assets/newsroom/media\\_kit/biogs/100223\\_sandy\\_flockhart.pdf](http://www.hsbc.com/1/PA_esf-ca-app-content/content/assets/newsroom/media_kit/biogs/100223_sandy_flockhart.pdf). HSBC also has affiliates in Colombia, Panama, Peru, and Uruguay, among other Latin American locations.

<sup>162</sup> In July 2007, Mr. Flockhart was appointed CEO of The Hongkong and Shanghai Banking Corporation Limited. See his biography on the HSBC website, [http://www.hsbc.com/1/PA\\_esf-ca-app-content/content/assets/newsroom/media\\_kit/biogs/100223\\_sandy\\_flockhart.pdf](http://www.hsbc.com/1/PA_esf-ca-app-content/content/assets/newsroom/media_kit/biogs/100223_sandy_flockhart.pdf).

<sup>163</sup> In May 2008, Mr. Thurston was appointed head of GF HSBC, and later co-head of the Latin American Region. See his biography on the HSBC website, [http://www.hsbc.com/1/PA\\_esf-ca-app-content/content/assets/newsroom/media\\_kit/biogs/101210\\_paul\\_thurston.pdf](http://www.hsbc.com/1/PA_esf-ca-app-content/content/assets/newsroom/media_kit/biogs/101210_paul_thurston.pdf); "HSBC makes key international appointments," (4/15/2008), <http://www.hsbc.com/1/2/newsroom/news/2008/hsbc-makes-key-international-appointments>.

he was promoted and relocated to London,<sup>164</sup> Luis Pena Kegel became the new HSBC Mexico CEO and remains in that post today.<sup>165</sup>

Mexican banks, including HBMX, are regulated by the Comision Nacional Bancaria y de Valores (CNBV) which oversees Mexican banks and securities firms. The Mexican central bank, Banco de Mexico, the Mexican Ministry of Finance, the Mexican Treasury Department (SHCP), and the Mexican Financial Intelligence Unit (FIU) also perform oversight functions. Mexico has a well-developed set of AML laws and regulations. Mexican regulators and law enforcement agencies work with their U.S. counterparts to combat drug trafficking and money laundering in both countries.

HBMX is a large, sophisticated bank offering a full range of banking services, including deposits, checking, foreign exchange, commercial banking services, private banking and wealth management, and correspondent banking. HBMX offers correspondent accounts to a wide range of financial institutions. HBMX also maintains correspondent accounts for itself at other banks around the world, including in the United States. In 2002, at the time Bital was purchased, the bank had \$647 million in correspondent banking deposits in Mexico, \$700 million in the Cayman Islands, and \$143 million in New York.<sup>166</sup> According to CEO Paul Thurston, HBMX experienced rapid growth in the early years after its acquisition.<sup>167</sup> HBMX also operates a branch in the Cayman Islands, HSBC Mexico S.A, which was established by Bital in 1980, with authority to offer customers U.S. dollar accounts.<sup>168</sup> At its peak in 2008, the Cayman branch, which has no offices or employees of its own and is run by HBMX personnel in Mexico, had nearly 50,000 client accounts and assets totaling \$2.1 billion.<sup>169</sup>

HBMX has had an extensive relationship with HBUS, obtaining U.S. dollar services through both correspondent and banknotes accounts. HBMX used its HBUS correspondent account primarily to process

<sup>164</sup> In May 2008, Mr. Thurston was appointed Managing Director of UK Banking, in charge of HSBC's retail and commercial banking operations in the United Kingdom. See "HSBC makes key international appointments," (4/15/2008), <http://www.hsbc.com/1/2/newsroom/news/2008/hsbc-makes-key-international-appointments>.

<sup>165</sup> Mr. Pena was appointed head of GF HSBC. Id. Mr. Pena had previously headed Grupo Financiero Banorte and worked for 25 years at Banamex/Citigroup in Mexico. Id. Emilson Alonso was appointed Chief Executive of HSBC Latin America. Id.

<sup>166</sup> "Compliance Due Diligence Trip by John Root: Bital (Mexico City) – 4-8 Nov02," prepared by HSBC John Root, HSBC OCC 8877802-807, at 5.

<sup>167</sup> Subcommittee interview of Paul Thurston (5/1/2012).

<sup>168</sup> This branch operates under a "Class B license," which is given by the Cayman Islands Monetary Authority to offshore banks authorized to do business only with non-residents of the Cayman Islands. See list of Cayman offshore banks at [http://www.offshore-library.com/banking/cayman\\_islands/page\\_3](http://www.offshore-library.com/banking/cayman_islands/page_3); Subcommittee briefing by HSBC legal counsel on the Cayman accounts (4/20/2012).

<sup>169</sup> See chart at HSBC OCC 8876787, attached to 9/12/2008 email from HSBC John Root to HSBC Adrian Cristiani, "Cayman Accounts," HSBC OCC 8876784.

international wire transfers and clear U.S. dollar monetary instruments such as travelers cheques. It also made use of HBUS' Remote Deposit Capture service which enabled HBMX to send monetary instruments to HBUS electronically for processing. HBMX interacted at times with the HBUS Payment and Cash Management (PCM) division regarding this account. In addition, HBMX interacted with the HBUS Global Banknotes division, until the Global Banknotes business was discontinued in 2010. HBMX used its banknotes account primarily to sell U.S. dollars received from its customers to HBUS, which HBMX typically transported to HBUS via armed car or aircraft. In one three-month period from November 2006 to February 2007, HBMX shipped nearly \$742 million in U.S. dollars to HBUS; at its peak, HBMX exported \$4 billion in bulk cash shipments to HBUS over the course of one year, 2008. Until it sharply curtailed its U.S. dollar services in Mexico in January 2009, HBMX shipped more U.S. dollars to HBUS than any other Mexican bank or HSBC affiliate.

## **B. Mexico**

To understand HBMX's AML risks and, therefore, the risks HBUS incurred as its U.S. correspondent, it is necessary also to understand the AML risks in its home country, Mexico. From 2000 until 2009, HSBC Group and HBUS gave Mexico their lowest AML risk rating, despite overwhelming information indicating that Mexico was a high risk jurisdiction for drug trafficking and money laundering. In May 2009, HBUS suddenly increased its risk rating for Mexico by three notches, from its lowest to its highest risk level, where it remains today.<sup>170</sup> HSBC Group did not follow suit until 2012 when it raised its risk rating for Mexico from "cautionary" to "high risk."<sup>171</sup>

### **(1) U.S. Assessment of AML Risk in Mexico**

**INCSR Reports.** In its annual International Narcotics Control Strategy Reports (INCSRs), which contain a country-by-country assessment of drug trafficking and money laundering risks, the U.S. State Department has consistently classified Mexico as a country of "primary" concern for money laundering, its highest risk rating.<sup>172</sup> In 2002, the State Department described Mexico's drug trafficking and money laundering risks as follows:

<sup>170</sup> See 4/9/2010 memorandum from OCC legal counsel to OCC Washington Supervision Review Committee, "Order of Investigation – HSBC Bank USA, N.A., New York, NY," OCC-PSI-00899482-485, at 484.

<sup>171</sup> Subcommittee briefing by HSBC legal counsel (7/5/2012).

<sup>172</sup> See, e.g., "2000 International Narcotics Control Strategy Report," U.S. Department of State (hereinafter "2000 INCSR"), at 621; 2002 INCSR at XII-60; 2006 INCSR Vol. II at 39; 2008 INCSR Vol. II at 62; 2012 INCSR Vol. II, at 33.

“Mexico faces a myriad of drug-related problems that include the production and transshipment of illicit drugs, money laundering, consumption and illicit firearms trafficking. ... The Government of Mexico’s (GOM) longstanding commitment to combat drug trafficking and related crimes resulted in tangible successes against the Arellano Felix Organization (AFO), the Carrillo Fuentes Organization (CFO), and the Gulf Cartel – widely considered the top three drug groups in the country. ... Mexico remains a major supplier of heroin, methamphetamine, and marijuana, and the transit point for more than one half of the cocaine sold in the U.S. ... The industrial-scale drug trade has transformed narcotrafficking into one of Mexico’s deadliest businesses. ... These organizations have demonstrated blatant disregard for human life as the executions of law enforcement personnel, government officials, and innocent bystanders have increased. ... In recent years international money launderers have turned increasingly to Mexico for initial placement of drug proceeds into the global financial system.”<sup>173</sup>

The State Department also wrote:

“The smuggling of bulk shipments of U.S. currency into Mexico and the movement of the cash back into the United States via couriers and armored vehicles, as well as through wire transfers, remain favored methods for laundering drug proceeds. Mexico’s financial institutions engage in currency transactions involving international narcotics-trafficking proceeds that include significant amounts of U.S. currency or currency derived from illegal drug sales in the United States. Although drug trafficking continues to be the principal source of the laundered proceeds, other crimes including corruption, kidnapping, firearms trafficking, and immigrant trafficking are also major sources of illegal proceeds.”<sup>174</sup>

Equally negative assessments of Mexico’s drug trafficking and money laundering risks appeared in the State Department’s annual INCSR reports over the next four years. In 2006, for example, the State Department wrote:

“The illicit drug trade continues to be the principal source of funds laundered through the Mexican financial system. Mexico is a major drug producing and drug-transit country. Mexico also serves as one of the major conduits for proceeds from illegal drug sales leaving the United States. Other crimes, including corruption, kidnapping, firearms trafficking, and immigrant

<sup>173</sup> 2002 INCSR, at V-27-V-28.

<sup>174</sup> Id. at XII-161.

trafficking are also major sources of illegal proceeds. The smuggling of bulk shipments of U.S. currency into Mexico and the movement of the cash back into the United States via couriers, armored vehicles, and wire transfers, remain favored methods for laundering drug proceeds. ...

According to U.S. law enforcement officials, Mexico remains one of the most challenging money laundering jurisdictions for the United States, especially with regard to the investigation of money laundering activities involving the cross-border smuggling of bulk currency from drug transactions. While Mexico has taken a number of steps to improve its anti-money laundering system, significant amounts of narcotics-related proceeds are still smuggled across the border. In addition, such proceeds can still be introduced into the financial system through Mexican banks or casas de cambio, or repatriated across the border without record of the true owner of the funds.”<sup>175</sup>

The State Department’s relentlessly negative assessments of Mexico’s drug trafficking and money laundering vulnerabilities continued unabated. In 2008, the State Department wrote that “U.S. officials estimate that since 2003, as much as U.S. \$22 billion may have been repatriated to Mexico from the United States by drug trafficking organizations.”<sup>176</sup> Four years later, in 2012, the State Department wrote that drug cartels were using Mexican and U.S. financial institutions to launder as much as \$39 billion each year: “According to U.S. authorities, drug trafficking organizations send between \$19 and \$39 billion annually to Mexico from the United States.”<sup>177</sup>

**Warnings.** The State Department is far from the only governmental agency to have warned about the money laundering risks in Mexico. The U.S. Congress has held repeated hearings over the years highlighting money laundering and drug trafficking problems in Mexico.<sup>178</sup> Witnesses have included the U.S. Justice Department,

<sup>175</sup> 2006 INCSR, at 268-269.

<sup>176</sup> 2008 INCSR, at 327.

<sup>177</sup> 2012 INCSR, at 140.

<sup>178</sup> See, e.g., “Money Laundering Activity Associated with the Mexican Narco-Crime Syndicate,” U.S. House Banking and Financial Subcommittee on General Oversight and Investigations, Serial No. 104-72 (9/5/1996); “Drug Control: Update on United States-Mexican Counternarcotics Efforts,” Senate Caucus on International Narcotics Control, S.Hrg. 106-60 (2/24/1999); “Federal Strategies to End Border Violence,” Senate Judiciary Committee, S.Hrg. 109-556 (3/1/2006); “Antidrug Package for Mexico and Central America: An Evaluation,” Senate Committee on Foreign Relations, S.Hrg. 110-311 (11/15/2007); “Escalating Violence in Mexico and the Southwest Border as a Result of the Illicit Drug Trade,” House Judiciary Subcommittee on Crime, Terrorism, and Homeland Security, Serial No. 111-25 (5/6/2009); “Exploring Drug Gangs’ Ever Evolving Tactics to Penetrate the Border and the Federal Government’s Ability to Stop Them,” Senate Homeland Security and Governmental Affairs Ad Hoc Subcommittee on Disaster Recovery and Intergovernmental Affairs, S.Hrg. 112-384 (3/31/2011).

Homeland Security Department, Federal Bureau of Investigations, Drug Enforcement Administration (DEA), Financial Crimes Enforcement Network (FinCEN) of the U.S. Treasury Department, Internal Revenue Service (IRS), Customs and Border Patrol, and Coast Guard, among others. From 1996 to 2011, these hearings have painted the same grim picture drawn in the State Department's annual reports regarding the drug trafficking and money laundering threats in Mexico.

In addition, warnings about money laundering problems in Mexico have been directed specifically to financial institutions operating in the United States. In 2005, multiple U.S. agencies worked together to produce a U.S. Money Laundering Threat Assessment which identified thirteen key money laundering methods and specifically identified Mexico as a high risk jurisdiction for several of them, including bulk cash smuggling, misuse of money orders, and suspicious funds sent through money service businesses.<sup>179</sup> In 2006, FinCEN issued an advisory to all U.S. financial institutions to "better guard against an increasingly prevalent money laundering threat involving the smuggling of bulk U.S. currency into Mexico," warning in particular against "the abuse of their financial services" by Mexican casas de cambio.<sup>180</sup> The advisory explained that drug traffickers were smuggling bulk cash from the United States into Mexico, then depositing the funds with casas de cambio who were sending the cash back to the United States via armored transport or by selling the U.S. dollars to U.S. banks.<sup>181</sup> The advisory also warned about multiple wire transfers that "bear no apparent business relationship" with a particular casa de cambio, and U.S. deposits by casas de cambio of sequentially numbered monetary instruments.<sup>182</sup>

**Wachovia Prosecution.** Criminal prosecutions also alerted U.S. financial institutions to the money laundering problems in Mexico. In 2008, for example, news articles warned how Mexican drug cartels sent millions of dollars in illegal drug proceeds through a major U.S. financial institution, Wachovia Bank.<sup>183</sup> In 2010, the United States filed a deferred prosecution agreement detailing how Wachovia Bank had

<sup>179</sup> See Dec. 2005 "U.S. Money Laundering Threat Assessment," issued by the Money Laundering Threat Assessment Working Group, which included the U.S. Departments of Treasury, Justice, and Homeland Security, Federal Reserve, and Postal Service.

<sup>180</sup> "Guidance to Financial Institutions on the Repatriation of Currency Smuggled into Mexico from the United States," FinCEN Advisory No. FIN-2006-A003 (4/28/2006), at 1. [http://www.fincen.gov/statutes\\_regs/guidance/pdf/advis04282006.pdf](http://www.fincen.gov/statutes_regs/guidance/pdf/advis04282006.pdf).

<sup>181</sup> *Id.* at 1-2.

<sup>182</sup> *Id.* at 2.

<sup>183</sup> See, e.g., "Wachovia Is Under Scrutiny in Latin Drug-Money Probe," *Wall Street Journal*, Evan Perez, Glenn Simpson (4/26/2008) (describing AML cases involving not only Wachovia Bank, but also American Express International Bank, which forfeited \$55 million as part of a 2007 Federal deferred prosecution agreement, and Union Bank of California, which forfeited \$21.6 million as part of a 2007 Federal deferred prosecution agreement, both of which were also charged with inadequate AML programs and suspected of being used by Mexican drug cartels to launder funds).

been used by Mexican foreign exchange businesses to launder at least \$110 million in drug proceeds.<sup>184</sup> Filings in the case describe how, from 2003 to 2008, Wachovia Bank provided a variety of services for 22 Mexican casas de cambio (CDCs), despite evidence of suspicious activity. Those services included processing numerous U.S. dollar wire transfers for deposit into bank accounts around the world,<sup>185</sup> clearing large volumes of sequentially numbered U.S. travelers cheques;<sup>186</sup> and accepting numerous bulk cash shipments transported by armored car from the CDCs.<sup>187</sup> The filings report that, over a three-year period, the wire activity exceeded \$374 billion and the bulk cash shipments exceeded \$4.7 billion, far exceeding expected volumes.<sup>188</sup> Wachovia Bank also processed \$20 million in sequentially numbered travelers cheques, the majority of which contained illegible names and unusual markings.<sup>189</sup> The deferred prosecution agreement and supporting factual statement charged Wachovia Bank with willfully failing to maintain an effective AML program,<sup>190</sup> detailing numerous AML deficiencies including a failure to conduct due diligence on high risk clients; a failure to monitor wire transfers, pouch activities, and bulk cash shipments; and a failure to report suspicious activity to law enforcement.<sup>191</sup> To avoid prosecution, Wachovia Bank acknowledged responsibility for its conduct, paid \$160 million in criminal and civil fines, and agreed to undertake significant AML reforms.<sup>192</sup> The Wachovia case received widespread media attention, providing further notice of the money laundering dangers in Mexico.<sup>193</sup>

## (2) HSBC Assessment of Risk in Mexico

Despite the overwhelming information available about substantial money laundering risks in Mexico, from 2002 until 2009, HBUS gave Mexico its lowest risk rating for AML purposes.<sup>194</sup> As a consequence,

<sup>184</sup> See *United States v. Wachovia Bank N.A.*, Case No. 10-20165-CR-Lenard (USDC SDFL), Deferred Prosecution Agreement (3/16/2010) and Information (3/12/2010).

<sup>185</sup> See *id.*, Factual Statement, Exhibit A to Deferred Prosecution Agreement (3/16/2010), at ¶¶ 20, 24(1).

<sup>186</sup> *Id.* at ¶¶ 22, 24(2), 35.

<sup>187</sup> *Id.* at ¶ 21, 24(3).

<sup>188</sup> *Id.* at ¶ 23.

<sup>189</sup> *Id.* at ¶ 35.

<sup>190</sup> See *United States v. Wachovia Bank N.A.*, Case No. 10-20165-CR-Lenard (USDC SDFL), Deferred Prosecution Agreement (3/16/2010), at ¶¶ 3-4.

<sup>191</sup> See *id.*, Factual Statement, Exhibit A to Deferred Prosecution Agreement (3/16/2010), at ¶¶ 28, 30-35.

<sup>192</sup> *Id.*, at ¶¶ 38-40; Deferred Prosecution Agreement (3/16/2010); "Wachovia Enters into Deferred Prosecution Agreement," U.S. Attorney's Office for the Southern District of Florida press release, (3/17/2010), <http://www.justice.gov/usao/fls/PressReleases/100317-02.html>.

<sup>193</sup> See, e.g., "Wachovia is Under Scrutiny in Latin Drug-Money Probe," *Wall Street Journal*, Evan Perez and Glenn Simpson, April 26, 2008; "How a big U.S. bank laundered billions from Mexico's murderous drug gangs," *The Observer*, Ed Vulliamy, (4/2/2011), <http://www.guardian.co.uk/world/2011/apr/03/us-bank-mexico-drug-gangs>.

<sup>194</sup> See, e.g., Feb. 2009 "Rating 2009," prepared by HBUS, HSBC-PSI-PROD-0096390-397 (rating over 235 countries and territories). [Sealed Exhibit.]



under HSBC Group policy, clients from Mexico were not subjected to enhanced monitoring by HBUS, unless they were also designated a Special Category Client (SCC), a relatively rare designation that indicates a client poses high AML risks. Had Mexico carried one of the two highest risk ratings, all Mexican clients at HBUS would have been subjected to enhanced due diligence and account monitoring. Instead, HBUS failed to conduct AML monitoring of most Mexican client account and wire transfer activity involving substantial funds.

**Risk Rating Process.** Until recently, HSBC Group and HBUS issued AML country risk assessments using four categories of increasing risk, “standard,” “medium,” “cautionary,” and “high.” HSBC Group created a chart listing its country risk assessments, sent the chart to its affiliates characterizing its assessments as recommendations, and then allowed each HSBC affiliate to make its own assessment decisions.<sup>195</sup> At HBUS, the country risk assessments were compiled every six months by an AML compliance officer who gathered information from a number of sources, assigned numerical scores to each source, and then compiled aggregate scores for over 200 countries.<sup>196</sup>

Those scores were then supposedly used to assign risk ratings. In fact, however, countries receiving similar scores often received different risk ratings. Those differences were attributable, in part, to an “HBUS discretion” factor which was listed as an official factor in the risk assessment process, included in the risk assessment chart, and used, according to the OCC, to alter the risk ratings for over 60 countries in 2009.<sup>197</sup> The OCC noted that HBUS offered “no discussion or documentation as to what constitute[d] permissible reasons to change the risk rating” using the HBUS discretion factor.<sup>198</sup> The OCC also found that HBUS did not apply its risk-rating methodology “in a consistent manner.” The OCC wrote that, in 2009, of 73 countries that received a zero risk assessment score:

“32 (44 percent) were rated standard, 32 (44 percent) were rated medium, 1 (1 percent) was rated cautionary, and 8 (11 percent) were rated Unclassified. The OCC found no documentation or support for the difference between the final ratings and the scores. While the bank elevated the risk ratings versus the scores, the bank has not adopted a repeatable, standardized procedure.”<sup>199</sup>

<sup>195</sup> Subcommittee interview of Ali Kazmy (2/29/2012).

<sup>196</sup> Id. See also Feb. 2009 “Rating 2009,” prepared by HBUS, HSBC-PSI-PROD-0096390-397.

<sup>197</sup> See 9/13/2010 OCC Supervisory Letter HSBC-2010-22, “Bank Secrecy Act/Anti-Money Laundering (‘BSA/AML’) Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21),” OCC-PSI-00864335-365, at 19. [Sealed Exhibit.]

<sup>198</sup> Id.

<sup>199</sup> Id.

The OCC criticized the HSBC country risk assessment process for not taking into account readily available country-specific information on money laundering and drug trafficking risks, including in the annual State Department INCSR reports.<sup>200</sup> Although INCSR information was often included in HBUS KYC client profiles, the INCSR country-specific risk ratings were inexplicably excluded from the official HBUS country risk assessment scoring matrix.<sup>201</sup>

Still another OCC criticism was the HSBC Group's "unacceptable practice of assigning an overall risk rating to its non-SCC customers based solely on the risk rating that the bank has given the country where the customer is located."<sup>202</sup> One result of this practice, according to the OCC, was that HSBC had excluded from its routine AML monitoring "more than \$60 trillion of wire transfers each year for customers domiciled in countries risk rated as 'standard' or 'medium,' representing two-thirds of the total dollar volume" of wire transfers at HSBC.<sup>203</sup> With respect to Mexico, the HSBC policy meant that, due to its low risk rating, all clients based in Mexico were considered low risk, unless rated an SCC, an outcome that the OCC viewed as a critical AML deficiency. One consequence was that high risk clients residing in low risk countries routinely escaped enhanced due diligence and account monitoring.

**2009 Change in Mexico Risk Rating.** In February 2009, HBUS issued a chart with its latest country risk assessments.<sup>204</sup> The chart provided risk scores and categories for 239 countries.<sup>205</sup> It assigned a score of "2" for Mexico, which was one of the lowest scores. When asked about this low score, the HBUS compliance officer then responsible for country risk assessments, Ali Kazmy, told the Subcommittee that, since 2006, HBUS' assessments had inadvertently failed to take into account a 2006 FinCEN advisory related to Mexico that would have added 10 points to its score each year.<sup>206</sup> As a result of its low score, Mexico was rated a "standard" risk, the lowest of the four risk ratings.<sup>207</sup>

<sup>200</sup> Id.

<sup>201</sup> See Feb. 2009 "Rating 2009," prepared by HBUS, HSBC-PSI-PROD-0096390-397.

<sup>202</sup> 9/13/2010 OCC Supervisory Letter HSBC-2010-22, "Bank Secrecy Act/Anti-Money Laundering ('BSA/AML') Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21)," OCC-PSI-00864335-365, at 18. [Sealed Exhibit.]

<sup>203</sup> Id. at 2.

<sup>204</sup> See Feb. 2009 "Rating 2009," prepared by HBUS, HSBC-PSI-PROD-0096390-397.

<sup>205</sup> Id. The risk scores ranged from 0 to 28, and produced ratings of standard, medium, cautionary, and high.

<sup>206</sup> Subcommittee interview of Ali S. Kazmy (2/29/2012). See also Feb. 2009 "Rating 2009," prepared by HBUS, HSBC-PSI-PROD-0096390-397. Mr. Kazmy took over the country risk rating process from Lynda Cassell who left HBUS in mid-2006. The FinCEN Advisory was issued in April 2006, just before Ms. Cassell left.

<sup>207</sup> Mexico had received the same standard rating in 2008. See 2008 HBUS Country Risk Assessment for Mexico at HSBC-PSI-PROD-0096398-441 and 422.

This low risk rating was awarded despite a May 2008 email from Susan Wright, AML Compliance head for the HSBC Group, singling out AML concerns related to Mexico. Referencing “RMM – Country Risk,” Ms. Wright wrote to HSBC Group Compliance head David Bagley and other colleagues:

“I believe you have sight of our Country Reputational Risk Table but, as previously discussed, unless there are some specific concerns it is not proposed to highlight the highest risk countries as a matter of course. ...

Mexico – there are specific risks in relation to pressure from the US with regard to the laundering of the proceeds of drug trafficking through Mexican cas[a]s de cambios. HBMX have a number of customers who are cambios/money service businesses (MSBs) with links to the US and consequently payments from HBMX are made through HBUS. ... [T]hese are notoriously difficult businesses to monitor .... [T]here is also US concern with regard to the amount of USD cash deposits and transactions between the US and Mexico and HBMX has been identified as one of the banks with the highest level of activity in this area.”<sup>208</sup>

This email shows that the head of HSBC AML Compliance was aware of and communicated to other Compliance personnel the serious AML risks related to Mexico involving drug trafficking, suspect casas de cambio, and bulk cash smuggling, yet the February 2009 HBUS country risk assessments again assigned Mexico the lowest possible risk rating.

Three months after issuing the country risk assessments in February 2009, however, on May 1, 2009, HBUS suddenly revised Mexico’s risk rating, increasing it by three notches from the lowest to its highest risk rating.<sup>209</sup> When asked by the Subcommittee about the timing, Mr. Kazmy explained that, “in early 2009,” he had been asked by his supervisor, Anne Liddy, to take another look at Mexico’s risk rating due to OCC concerns.<sup>210</sup>

Ms. Liddy’s request coincided with an intensifying law enforcement interest in Mexican casas de cambio suspected of laundering illegal drug proceeds through U.S. financial institutions, including HBUS. In February 2008, and again in November 2008, as detailed below, Mexican regulators confronted HBMX with suspicions that drug proceeds were moving through its accounts at HBUS. In

<sup>208</sup> 5/14/2008 email from HSBC Susan Wright to HBUS David Bagley, HSBC Karl Barclay, HBEU Derek Leatherdale, and others, “RMM – Country Risk,” HSBC OCC 8873750.

<sup>209</sup> See 4/9/2010 memorandum from OCC legal counsel to OCC Washington Supervision Review Committee, “Order of Investigation – HSBC Bank USA, N.A., New York, NY,” OCC-PSI-00899482-485, at 484.

<sup>210</sup> Subcommittee interview of Ali S. Kazmy (2/29/2012).

January 2009, according to an internal HBUS email, a U.S. Homeland Security Department's Immigration and Customs Enforcement (ICE) agent met with HBUS about a money laundering investigation involving one of their clients in Mexico.<sup>211</sup> That same month, in response to Mexican AML regulatory concerns, HBMX stopped accepting U.S. dollar deposits at any of its Mexican branches.

In June 2009, ICE also informed the OCC that ICE was investigating possible money laundering activity involving banknote accounts at HBUS.<sup>212</sup> ICE indicated that Mexican drug traffickers appeared to be using the black market peso exchange in New York to transfer funds through a particular Mexican financial institution, which then sent the funds through its U.S. correspondent account at HBUS.<sup>213</sup> Dan Stipano, OCC Deputy Chief Counsel, explained the scheme to the OCC Examiner-In-Charge at HBUS as follows:

"The scheme ... is similar to activity that we have seen at Union Bank, Wachovia, and Zions. Basically, the way it works is that drug money is physically hauled across the border into Mexico, then brought back into the United States through wire transfers from casas de cambio or small Mexican banks, or else smuggled across the border in armored cars, etc., before being deposited in U.S. institutions. According to AUSA [Assistant U.S. Attorney] Weitz, most U.S. banks, recognizing the risks involved, have gotten out of this business, but HSBC NY is one of the last holdouts (although, interestingly, he said that HSBC-Mexico will no longer accept U.S. currency)."<sup>214</sup>

What U.S. law enforcement officials had found was that, because drug traffickers in the United States were having difficulty finding a U.S. financial institution that would accept large amounts of cash, due to strict U.S. AML controls, many were instead transporting large volumes of U.S. dollars to Mexico, and depositing the dollars at Mexican financial institutions. The drug traffickers could then keep their deposits in U.S. dollars through the Mexican financial institution's correspondent account at a U.S. bank, or exchange the dollars for pesos. The Mexican

<sup>211</sup> See 1/19/2009 email from HBUS Denise Reilly to HBUS Lesley Midzain, "HBMX Banknotes Business – HSBC Mexico Press Release and Q&A," HSBC OCC 3633806-807. In a Subcommittee interview, HBUS AML Compliance officer Daniel Jack indicated that he attended the meeting, and the ICE agent expressed concern about possible money laundering through Consultoria, a former Mexican casa de cambio that had converted into a bank. Mr. Jack told the Subcommittee that HBUS closed the Consultoria account six months later. Subcommittee interview of Daniel Jack (3/13/2012).

<sup>212</sup> See 9/29/2009 email from Dan Stipano to Sally Belshaw, at 3, OCC-PSI-00928758; 6/28/2009 notes of telephone conversations, prepared by OCC Jim Vivennzio, OCC-PSI-00928759-761 (noting ICE agents had met with HBUS). [Sealed Exhibit.]

<sup>213</sup> See 6/28/2009 notes of telephone conversations, prepared by Jim Vivennzio, OCC-PSI-00928759. [Sealed Exhibit.]

<sup>214</sup> See 9/29/2009 email from Dan Stipano to Sally Belshaw, at 3, OCC-PSI-00928758.

banks, casas de cambio, and other financial institutions that were the recipients of the cash typically shipped the physical dollars back to the United States for credit to their own U.S. dollar correspondent accounts at U.S. banks. HBUS' awareness of the increasing U.S. law enforcement and regulatory interest in Mexico may have contributed to its decision to review and, ultimately, in May 2009, to increase its risk rating for Mexico.

One key consequence of the higher risk rating for Mexico was that, under Group AML policy, HBUS was required to conduct enhanced monitoring of all of its Mexican clients. HBUS' higher risk rating may have also put pressure on HSBC Group and other HSBC affiliates to boost their risk rating of Mexico as well.

On June 18, 2009, Ms. Wright sent an email to Ms. Liddy asking her about the higher rating for Mexico. Ms. Wright wrote:

"It has been drawn to my attention that in the latest US Country Risk Assessment Mexico has gone from a lower risk to high. I have received a number of queries from around the Group as to the reason for what they see as quite a dramatic change.

Whilst I appreciate the risks involved in doing business with Mexico I would be grateful for some further and more detailed clarification as to why the change has been so dramatic. This will enable me to deal with a number of these queries."<sup>215</sup>

In response, Ms. Liddy asked Mr. Kazmy, the AML officer responsible for compiling the country risk ratings, to write up the reasoning for the higher risk rating. He wrote:

"A number of sources are reviewed, a majority of which are government and international agencies, such as World Bank, IMF, FATF, CFATF, BIS, Central Banks, Transparency International, etc. in order to determine risk levels .... The U.S. Department of State issues detailed annual assessment[s] of each country via the International Narcotics Control Strategy Report highlighting, inter

<sup>215</sup> 6/18/2009 email from HSBC Susan Wright to HBUS Anne Liddy, "Group CRRT and US Country Risk Assessments," OCC-PSI-00652829. See also 6/9/2009 email from HSBC David Bagley to HBMX Emilson Alonso, copies to HSBC Michael Geoghegan and others, "GMO Business reviews - LATAM," HSBC OCC 8874895 ("I fully acknowledge the level of priority and focus that you and the team have given to these issues and the progress that has been made particularly in Mexico and have taken all of this into account. ... The basis for the rating is however: The inherent AML risk in Mexico is still very high and [t]here are not many other parts of the Group that have what is effectively a drugs war being conducted on the streets and also have the risk posed by potential sting and other operations by the US authorities. We have of course remediated our high risk accounts, but the historic weak account opening processes mean that we have overall lower levels of KYC across the customer base as a whole. ... Happy to discuss further:").

alia, money laundering, terrorist financing, corruption, and regulatory regime/oversight. An excerpt of such a report on Mexico ... is attached below. ...

As a result of events occurring in Mexico during the past several months with respect to drug trafficking and money laundering, as well as the general unrest these developments have caused, we have downgrade[d] Mexico to 'high' risk. The deteriorated situation is recognized by the Government of Mexico as evidence through the involvement of agencies tasked with the Anti-Money Laundering and Counter Financing of Terrorist (AML/CFT) efforts towards drafting an AML/CFT National Strategy ... expect[ed] to be issued sometime during 2009. ... Our rating is in conformity with the view of the U.S. law enforcement."<sup>216</sup>

Ms. Liddy asked him how Mexico had been rated by the State Department in 2009, and whether that rating was worse than in the previous report, apparently not realizing that the State Department had consistently given Mexico its highest risk rating for years.<sup>217</sup> Mr. Kazmy told Ms. Liddy, incorrectly, that the State Department INCSR report did not rate countries for risk, but also provided numerous details from the 2009 INCSR report indicating that money laundering and drug trafficking risks had increased.<sup>218</sup>

In 2010, when the OCC sent HBUS a supervisory letter on AML deficiencies at the bank, the letter included criticism of its country rating system.<sup>219</sup> Under the heading, "Inadequate and Ineffective Procedures for Country Risk Ratings," the OCC listed "significant flaws" with the scoring and risk rating methodology, as well as with HBUS' decision not to monitor wire transfer activity for foreign financial institutions or other clients located in a standard or medium risk country, unless designated as an SCC client. The OCC wrote:

"The bank's country risk ratings for its PCM [Payment and Cash Management division] wire monitoring are critical, due to the bank's unacceptable practice of assigning an overall risk rating to its non-SCC customers based solely on the risk rating that the bank has given the country where the customer is located. However, compounding this deficiency, the bank's procedures for

<sup>216</sup> 6/19/2009 email from HBUS Ali Kazmy to HBUS Anne Liddy, "Group CRRT and US Country Risk Assessments," OCC-PSI-00652829.

<sup>217</sup> 6/22/2009 email from HBUS Anne Liddy to HBUS Ali Kazmy, "Group CRRT and US Country Risk Assessments," OCC-PSI-00652829.

<sup>218</sup> 6/24/2009 email from HBUS Ali Kazmy to HBUS Anne Liddy, "Group CRRT and US Country Risk Assessments," OCC-PSI-00652829.

<sup>219</sup> See 9/13/2010 OCC Supervisory Letter HSBC-2010-22, "Bank Secrecy Act/Anti-Money Laundering ('BSA/AML') Examination - Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21)," OCC-PSI-00864335-365, at 18-20. [Sealed Exhibit.]

determining the critical country risk ratings are inadequate and ineffective.

To determine the country risk rating, the bank employs a point system based on fifteen factors. HBUS' methodology appears straightforward ... [h]owever ... there are significant flaws in the implementation of the point system. ...

The bank's failure to risk rate countries appropriately has a significant impact on HBUS' BSA [Bank Secrecy Act] compliance, because customers' risk ratings affect a number of variable requirements relating to due diligence for foreign correspondents. For example, these variable requirements include the frequency with which the bank conducts site visits (every 12 months versus every 24 months) and the level of due diligence performed on beneficial owner and the senior management team."<sup>220</sup>

When asked why past risk assessments of Mexico had been so low, Mr. Kazmy told the Subcommittee that he was unable to explain the low ratings prior to 2009.<sup>221</sup> He indicated that he first saw the 2006 FinCEN advisory on Mexico in 2009.<sup>222</sup> He also indicated that, if he had known what he later learned, he would have increased the risk rating earlier.<sup>223</sup>

### C. HBMX's History of Weak AML Safeguards

In addition to the substantial money laundering and drug trafficking risks plaguing Mexico for a decade, HBMX itself had a history of weak AML controls and a poor compliance culture, which the HSBC Group worked for years to improve, with limited success. While HSBC Group officials in London were well aware of HBMX's AML deficiencies and were immersed in an effort to strengthen them, it did not inform its worldwide affiliates, including HBUS, of the problems. From 2002 until recently, HBUS remained largely ignorant of the extent of HBMX's AML and compliance deficiencies, despite providing HBMX with extensive correspondent services and giving it free access to the U.S. financial system.

<sup>220</sup> Id. at 18, 20. See also 4/9/2010 memorandum from OCC legal counsel to OCC Washington Supervision Review Committee, "Order of Investigation – HSBC Bank USA, N.A., New York, NY," OCC-PSI-00899482-485, at 3-4. The problems with HBUS' country risk assessments extended beyond Mexico to other countries as well. Some of the countries that should have been rated as having a high risk of money laundering, but were instead rated standard or medium, included Antigua, the Bahamas, Cayman Islands, and Switzerland. See Feb. 2009 "Rating 2009," prepared by HBUS, HSBC-PSI-PROD-0096390-397. As a consequence, clients from those jurisdictions were treated as low risk, and wire transfers involving those countries were not routinely monitored by HBUS.

<sup>221</sup> Subcommittee interview of Ali S. Kazmy (2/29/2012).

<sup>222</sup> Id.

<sup>223</sup> Id.

**Non-Existent Compliance Function in 2002.** In 2002, as part of its decisionmaking process to purchase Bital, HSBC Group reviewed Bital's compliance function, found it wholly inadequate, and determined that a major effort would be needed for the new bank to meet Group standards. In an email to his colleagues, David Bagley, head of HSBC Group Compliance, put it this way:

"Sandy [Flockhart, HSBC Mexico head,] acknowledges the importance of a robust compliance and money laundering function, which at present is virtually non-existent. ... There is no recognizable compliance or money laundering function in Bital at present .... Sandy thinks it is important to look both at issues affecting Mexico City, but also closer to the border where there appears to be substantial cross-border flows of monies, including USD [U.S. dollars] in cash."<sup>224</sup>

His comments followed a July 2002 audit performed by HSBC Group auditor prior to purchasing the Mexican bank providing a negative assessment of the bank's compliance program. The HSBC internal audit report detailed a wide range of specific problems as well as broader AML deficiencies:

- "FRBNY [Federal Reserve Bank of New York] review in 12/2000 identified that 82 of the 248 accounts reviewed lacked full documentation.
- A review ... of documentation of accounts booked at the target's Cayman Islands branch ... found that 41% of the accounts reviewed (92 of 224 reviewed) lacked full client information. 37 files had no client information. ...
- The [monitoring] system does not have any capacity to aggregate transaction activity for any period other than a given day ... [and] does not identify high risk clients as such. ...
- Private banking operations per se, are not identified. ...
- GFB [Grupo Financiero Bital] was involved in Operation Casa Blanca, a US government undercover sting operation undertaken to combat drug trafficking and money laundering activities in the US and Mexico. A former GFB account executive was found willing to establish fictitious accounts and moved illegal money through them. ... GFB forfeited \$3.1 [million] to the US government in 1998. ...

<sup>224</sup> 7/10/2002 email from HSBC David Bagley to HSBC John Root, with copies to Sandy Flockhart and Richard Bennett, "Bital," HSBC OCC 8877797-798.



### Conclusions

The GFB Compliance effort is weak, and it appears that the target organization does not have a strong Compliance culture.

- GFB does not, in reality, have a Compliance Department and one would have to be established and implemented ....
- Reviews of account opening procedures and client documentation are sporadic, and the reviews normally do not encompass large populations of client files or activities. This effort needs to be strengthened.
- Client transaction and activity monitoring is very limited. The reliance on account managers to identify and report unusual and suspicious transactions of their clients is a serious internal control shortcoming. ... High risk clients receive no special monitoring coverage. ...
- Internal and external audit recommendations, and issues raised in regulatory reports do not receive proper respect and action. ...
- Measures to promote and ensure staff discipline are not satisfactory. GFB's Code of Conduct lacks content, detail and spirit. ... Appropriate staff related policies would have to be implemented immediately as part of the overall effort to install a dedicated Compliance and internal control culture throughout the organization."<sup>225</sup>

Despite Bital's weak compliance function, HSBC Group completed the purchase on November 22, 2002.<sup>226</sup>

**Five Years of Effort.** Over the next five years, from 2002 to 2007, HSBC Group initiated a number of efforts to strengthen Bital's compliance and AML programs. While improvements were made, significant deficiencies persisted.

In November 2002, immediately before purchasing Bital, John Root, a senior HSBC Group Compliance expert whom David Bagley asked to help work on AML issues at HBMX, visited the bank for a week and prepared a report cataloguing compliance issues and needed initiatives.<sup>227</sup> Among other problems, his report noted the "lack of a

<sup>225</sup> July 2002 "Group Internal Audit: Due Diligence Review – Project High Noon," HSBC audit of Bital, HSBC OCC 8873846 -852.

<sup>226</sup> See 11/29/2002 minutes of HSBC Holdings plc Board of Directors, section 109.3, HSBC-PSI-PROD-0198570.

<sup>227</sup> "Compliance Due Diligence Trip by John Root: Bital (Mexico City) – 4-8 Nov02," prepared by HSBC John Root, HSBC OCC 8877802-807. See also 11/25/2002 email from HSBC John Root to HSBC Richard Bennett and HSBC Matthew King transmitting the report, HSBC OCC 8877800 ("There is very little of what we would call a Compliance function. ... I did not

'control culture' at Bital."<sup>228</sup> The report also described a meeting with one of Bital's chief Mexican regulators who "was extremely critical" of the bank, repeating a number of times that controls "do not exist."<sup>229</sup> The report noted that "some of his harshest criticism" were directed at the Bital Legal Department "which he averred was 'not guilty of bad faith but extreme mediocrity.'"<sup>230</sup> According to the report, the Mexican regulator recommended "sweeping changes in management."<sup>231</sup>

The report noted that Bital had 83 correspondent relationships with other financial institutions, including 20 well known and reputable banks and some institutions that required additional KYC information.<sup>232</sup> Mr. Root recommended obtaining that added KYC information or closing some of those accounts by March 2003. The report also noted that Bital had accounts lodged at its own Cayman branch office, which operated as an offshore shell entity and was managed by Bital employees in Mexico City. The report recommended undertaking an analysis of all of the correspondent banking deposits, "particularly those in the Cayman Islands," by June 2003. It also recommended an analysis of "all existing Private Banking, with particular attention to USD [U.S. dollar] accounts and fund transfers to New York and the Cayman Islands."<sup>233</sup> In addition, it recommended developing a better electronic screening system for all account activity to identify suspicious transactions and a better process for investigating suspicious activity "without any tipping off."<sup>234</sup>

In 2002 and 2003, HSBC Group appointed a new Compliance head for HBMX, Ramon Garcia Gibson, formerly AML Director at Citibank's Mexican affiliate, Banamax; established an HBMX Compliance Department; hired additional staff; and installed a new monitoring system known as Customer Account Monitoring Program (CAMP) to detect suspicious activity. HBMX also hired a Money Laundering Deterrence (MLD) Director Carlos Rochin. Nevertheless, in 2003, two inspection reports from Mexican authorities in January and August identified ongoing problems with the detection of suspicious transactions and the adequacy of the bank's Money Laundering

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encounter anybody at Bital who I thought immediately capable of building a Compliance department.").

<sup>228</sup> "Compliance Due Diligence Trip by John Root: Bital (Mexico City) – 4-8 Nov02," prepared by HSBC John Root, HSBC OCC 8877802-807, at 1.

<sup>229</sup> Id.

<sup>230</sup> Id.

<sup>231</sup> Id. at 2.

<sup>232</sup> Id. at 4.

<sup>233</sup> Id. at 6. Mr. Root told the Subcommittee that he became aware of the HBMX Cayman accounts at that time, but thought they were servicing Cayman residents. Subcommittee interview of John Root (4/26/2012).

<sup>234</sup> Id. at 4-5.

Deterrence (MLD) handbook, which HSBC was then in the process of revamping.<sup>235</sup>

In January 2004, HSBC Group's Board of Directors met in Mexico to allow Board members to familiarize themselves with HBMX.<sup>236</sup> During the meeting, the Board's Audit Committee reviewed HBMX's ongoing internal control issues. The Audit Committee's minutes stated that, "after being part of the Group for some 15 months," HBMX had made "very significant progress in raising the standards of its controls. It will, however, probably take another two years to fully reach Group standards. From experience with other acquisitions this is not unexpected."<sup>237</sup>

Five months later, in May 2004, HBMX's internal auditors filed a report containing a number of criticisms of the bank's compliance and AML efforts, indicating that much still needed to be done to cure its AML deficiencies.<sup>238</sup> Finding HBMX's AML function to be operating "Below Standard," the internal audit report stated:

"HBMX has insufficient controls to detect money laundering transactions in all areas of the Group in a timely manner. The implementation of the CAMP system is in process yet it only includes the Bank's transactions that have been registered in the Hogan system and fails to monitor those registered in other IT systems/HBMX subsidiaries.

Direccion de Prevencion de Lavado de Dinero [Direction of Money Laundering Deterrence] has identified high-risk areas of money laundering transactions, which are not being monitored.

The communication between LCOs [Local Compliance Officers] and Compliance does not enable the timely detection of the needs and weaknesses of the areas and subsidiaries.

There are inadequate internal controls over the IT systems used to send information to the regulator on suspicious or relevant transactions to authorities.

<sup>235</sup> See 1/22 and 26/2004 email exchanges among HBMX Ramon Garcia and HSBC John Root, Susan Wright, and David Bagley, "MLD Regulatory Report," HSBC OCC 8873393-394

<sup>236</sup> 1/30/2004 minutes of HSBC Holdings plc Board of Directors, section 04/7, HSBC-PSI-PROD-0198571-572.

<sup>237</sup> Id. at 572.

<sup>238</sup> May 2004 "Informe General de Auditoria HBMX GAQ 040026 Compliance-Money Laundering," prepared by HSBC Group's internal audit (Auditoria Interna Del Grupo), HSBC OCC 8874376-381.

In our opinion, based upon the foregoing, the Direction of Money Laundering Deterrence is operating with a **BELOW STANDARD** level of Control Risk.”<sup>239</sup>

Three months later, in August 2004, John Root, a senior HSBC Group Compliance officer, again visited HBMX to examine the status of its compliance and AML efforts, prepared a report, and sent it to senior officials at both HBMX and HSBC Compliance.<sup>240</sup> The report indicated that, while substantial progress had been made over the past 18 months, AML deficiencies remained:

“Senior management has made significant progress in introducing Group Compliance Policy and Standards in HBMX. The head of the Compliance department, Ramon Garcia Gibson, has set the foundation for an effective Compliance function.

HBMX controls are much improved from the situation that existed 12-18 months ago[.] However, Treasury back-office operations are a source of major regulatory concern, as is accurate and timely reporting to regulators. ...

[O]ne of the five commissioners of the CNBV ... states, ‘In the business area [of HBMX], the resources have arrived. In the area of controls, the resources have not arrived.’

The CNBV gave us a ‘fact sheet’ in English with the following ‘main concerns’ ....

**Anti-money laundering processes** – Although improvements have been seen, some concerns remain regarding deficiencies in process (no system for unusual operations detection and a poor identification of public figures and high risk customers) and over control of Panama’s branch operations. ...

In a wide-ranging discussion, CNBV regulators commented that any outsourcing must be able to be audited from Mexico. They do not want outsourcing to jurisdictions with strong banking secrecy. ...

The Trusts department is struggling to improve the poor condition of its files. Notwithstanding a senior manager’s optimism [‘Most

<sup>239</sup> Id. at 4 (emphasis in original).

<sup>240</sup> “HBMX Jul04 GHZ CMP Visit Report,” prepared by HSBC John Root, HSBC OCC 8875567-575. See also 8/10/2004 email from HSBC John Root to HSBC David Bagley, Richard Bennett, Matthew King, David Leighton, and Susan Wright, and HBMX Sandy Flockhart and Ramon Garcia, transmitting the report, HSBC OCC 8875565-575.

of them, KYC is okay' and 'Most deficiencies are not related to KYC'], by far the greatest problem *is* missing KYC documentation.

Of a total of 15,434 trusts, only 6,868 (41%) have completed documentation. 2,955 (20%) of trusts have no documentation at all. ...

Around USD 16 billion arrive from the United States each year, mostly through the branch network. Money laundering risk is mitigated by several factors: (1) remittances are generally small (US200-300), according to two senior managers; (2) due diligence appears to be adequate on the AML procedures of US third-party money services businesses; and (3) CAMP Retail, a software programme to detect suspicious transactions, is scheduled to be installed in the branch network in NOV04.

**Recommendation:** HBMX CMP [Compliance] should sample periodically remittances from the United States to determine if, in fact, remittances are generally small and in the ordinary course of business."<sup>241</sup>

In September 2004, the CNBV conducted an inspection of HSBC's AML efforts and, contrary to the more positive tone described by HBMX internally, found them unsatisfactory. According to an internal HBMX compliance report, a CNBV report summarizing the 2004 inspection criticized HBMX for:

"not considering the risk exposure of the customer to determine the appropriate visitation process, not implementing procedures to update annually the files of high-risk customers and politically exposed persons, not defining internal criteria to determine customers' risk exposure and a delay in formalizing the Communication and Control Committee ... responsible for sending SARs to the CNBV ... and issuing money laundering deterrence policies."<sup>242</sup>

The Communication and Control Committee (CCC Committee, also called the Money Laundering Deterrence or MLD Committee), which was mandated by a 2004 Mexican law, was intended to act as the bank's primary internal unit to deter money laundering, so the delay in getting the committee underway was seen as a major AML deficiency. CNBV

<sup>241</sup> "HBMX Jul04 GHZ CMP Visit Report," prepared by HSBC John Root, HSBC OCC 8875567-575 (emphasis in original).

<sup>242</sup> "1Q07 Compliance Report to the CIBM Audit Committee," prepared by the HBMX Corporate, Investment Banking and Markets (Private) Audit Committee, HSBC OCC 8873286-287 (describing CNBV criticisms).

later fined HBMX more than \$75,000 for the AML deficiencies identified in 2004, a fine which HBMX CIBM Compliance proposed contesting.<sup>243</sup>

In early 2005, an internal HBMX whistleblower hotline disclosed that HBMX compliance officials had fabricated records of mandatory monthly meetings by the CCC Committee, and provided the false records to a local CNBV regulator.<sup>244</sup> An HBMX investigation determined that the false records consisted of attendance sheets and minutes for CCC meetings that should have taken place from July to December 2004, but did not.<sup>245</sup> They were fabricated by a junior employee at the direction of the HBMX Money Laundering Deterrence Director, Carlos Rochin, who then tendered his resignation and left the bank.<sup>246</sup> Ramon Garcia, head of HBMX Compliance and the CCC Committee chair, received a written warning and was barred from receiving what would have been a substantial bonus for his work in 2004. David Bagley, head of HSBC Group Compliance, wrote:

“Overall RG [Ramon Garcia] has performed credibly, has worked very hard, and would otherwise be hard to replace. In the circumstances whilst we will need to keep his position under review at this stage I endorse the decision to retain his services given that his failure is limited to one of failing to supervise a very senior and trusted subordinate.”<sup>247</sup>

Mr. Bagley’s internal report found that the HBMX AML staff was riven by dissension and resentment and may have “exact[ed] retribution” against the MLD director for the dismissal of a colleague. His report concluded that Mr. Garcia would have to rebuild a “shattered Money Laundering Section.”<sup>248</sup> It also noted that CNBV “reiterated ... that, by comparison with other Mexican financial institutions, HBMX CMP [Compliance] appeared to be understaffed” and urged the bank to hire additional compliance personnel.<sup>249</sup>

In May 2005, John Root, a senior HSBC Group Compliance officer, made another visit to HBMX for several days to evaluate its

<sup>243</sup> Id.

<sup>244</sup> See 1/21/2005 email from HSBC David Bagley to HSBC Stephen Green and Richard Bennett, “Compliance Exception,” HSBC OCC 8873671.

<sup>245</sup> See 2/16/2005 email from HSBC David Bagley to HSBC Stephen Green and Richard Bennett, “Disclosure Line – HBMX CMP,” HSBC OCC 8873673; Feb. 2005 “HSBC Whistleblower Item 15 – HBMX: Investigation Report – Executive Summary,” prepared by Head of Group Audit Mexico (GAQ)(hereinafter “Whistleblower Report”), HSBC OCC 8877877-885.

<sup>246</sup> Whistleblower Report at 5-6.

<sup>247</sup> 2/16/2005 email from HSBC David Bagley to HSBC Stephen Green and Richard Bennett, “Disclosure Line – HBMX CMP,” HSBC OCC 8873673.

<sup>248</sup> Whistleblower Report at 7.

<sup>249</sup> Id. at 8.

compliance and AML efforts. As before, he later prepared a report and provided it to colleagues at HSBC Group and HBMX. In a separate email transmitting the report six weeks later, Mr. Root noted that the HBMX MLD director who resigned in January 2005, had not been replaced despite the passage of six months, and a new director needed to be appointed “as soon as possible in order to reorganize promptly a demoralized department and improve AML controls.”<sup>250</sup> The email noted the importance of “an independent, effective professional in the sensitive role of head of AML in Mexico.” He also observed that “[p]rojects are started but seldom completed, perhaps because of the many ministerial tasks that have accrued since the departure” of the MLD director. Mr. Root wrote:

“As you of course know, the work has piled up in the Compliance department, and Ramon needs help with the backlog. It is true that we have increased staff in the department, but they are mostly entry-level analysts in need of direction. It is important we hire an MLCO [Money Laundering Control Officer] as quickly as possible, and perhaps also a sort of ‘operating officer’ for Ramon to enable him to bring the department up to Group Standards.”<sup>251</sup>

Mr. Bagley forwarded the Root email to a colleague and commented that “until we have the right amount and mix of resources I cannot see [how] Ramon can make progress.”<sup>252</sup> Later that year, Leopoldo R. Barroso was appointed MLD director for HMBX.

In November 2005, Richard Bennett, then HSBC Group General Manager of Legal and Compliance and the person to whom David Bagley, head of HSBC Group Compliance, reported, paid a brief visit to HMBX.<sup>253</sup> While there, he met with the bank’s CNBV regulators who raised a variety of compliance issues. According to an email sent by Mr. Bagley, the concerns included the nature of the HBMX accounts in the Cayman Islands; the referral of clients to Mexico by other HSBC affiliates, especially in France; and access to HBMX AML information from other countries, in particular the United Kingdom.

In December 2005, HBMX’s internal audit group produced a 55-page report identifying a host of compliance and AML problems at the bank.<sup>254</sup> It found that HBMX Compliance had improved, but still rated

<sup>250</sup> 7/6/2005 email from HSBC John Root to HSBC David Bagley, Susan Wright, and David Leighton, “Visit to HBMX – 18 – 25 May 2005,” HSBC OCC 8876670-671.

<sup>251</sup> *Id.*

<sup>252</sup> 7/6/2005 email from HSBC David Bagley to HSBC Richard Bennett, “Visit to HBMX – 18 – 25 May 2005,” HSBC OCC 8876670.

<sup>253</sup> See 11/15/2005 email from HSBC David Bagley to HSBC John Root, “HBMX – Compliance Issues,” HSBC OCC 8873264-266.

<sup>254</sup> See Dec. 2005 “Informe de Auditoria General: HBMX – Direccion de Compliance,” prepared by Mexico Group Audit, HSBC OCC 8876223-280.

it “Below Accepted Levels.” Major deficiencies included a failure to make full use of the new CAMP monitoring system, a failure to ensure its monitoring parameters met local requirements, inefficient monitoring processes which made detection and analysis of alerts difficult, failure to apply CAMP to foreign remittances and HBMX subsidiaries, inadequate SCC risk profiles, failure to complete a MLD work plan, and inadequate training.<sup>255</sup>

The audit report was actually issued to HBMX in the spring of 2006, and its findings were hotly contested by the HBMX MLD Director, Leopoldo Barroso.<sup>256</sup> He communicated his views to HSBC Group Compliance and complained that the bank would be required to forward the audit report to the CNBV, which would not only create a “misleading” impression, but also would contradict a recent presentation HBMX had made on how its AML controls had improved.<sup>257</sup> John Root, senior HSBC Group Compliance officer, forwarded HBMX AML’s response to the audit findings to Susan Wright, head of AML and David Bagley, head of Compliance for HSBC Group.<sup>258</sup> Mr. Root commented:

“[T]he audit points are being strongly rejected by HBMX AML. AML is also alleging errors of procedure .... Many, if not most, of the recommendations were ‘rejected’ or downgraded in importance by AML, which is certainly a heartfelt, but rather unusual formal reaction, to an audit. Most of just accept audit recommendations, whether perceived to be ‘fair’ or not, and proceed to implement them.

I have let the dust settle a bit, as AML management clearly feel aggrieved, but closer monitoring is warranted on the specific audit recommendations. ...

[T]he one that most sticks out is apparent lack of monitoring of the (relatively few) AML staff in the field. This raises a ‘red flag’ in a place like Mexico, where the drug cartels are very powerful and ubiquitous. ... To aver, as the audit does, that ‘we do not really know what our man in the field is doing’ is a warning sign, if true. AML of course vigorously deny this.”

Mr. Barroso’s email responding to the internal audit noted that HBMX MLD had also recently been audited by CNBV and expected to receive a

<sup>255</sup> Id., Executive Summary.

<sup>256</sup> See 5/17/2006 email from HSBC John Root to HSBC Susan Wright and David Bagley, “Internal Audit Reports,” attaching 5/8/2006 email from Leopoldo Barroso and a chart entitled, “Internal Audit Main Findings to MLD,” HSBC OCC 8874383-392.

<sup>257</sup> Id.392

<sup>258</sup> Id. 383.



satisfactory rating, with only two requirements for improvements and several recommendations.<sup>259</sup>

HSBX's internal audit group continued to conduct compliance and AML examinations of HBMX offices and branches. In September 2006, for example, it examined operations at four HBMX district offices, each with more than 15 branches, located in the cities of Puebla, Morelos, and Juarez.<sup>260</sup> All four district offices were found to be operating "Below Standard" with respect to their risk controls, which was the same low rating each had received the prior year. For example, all four were found to have KYC and "file integrity" issues that "failed to comply with Group policies."<sup>261</sup> One district office was found to lack knowledge of the procedures to identify Special Category Clients (SCCs).<sup>262</sup> All four district offices had five or six repeat recommendations from prior audits that had yet to be resolved. All four summary reports were circulated to HSBC Group Compliance senior officials.<sup>263</sup>

In October 2006, HBMX's Compliance head Ramon Garcia informed HSBC Group Compliance that HBMX's Money Laundering Deterrence (MLD) Committee had adopted a policy that would require HBMX to consider closure of an account after four Suspicious Activity Reports (SARs) had been filed with respect to an account's activity.<sup>264</sup> In response, John Root, senior HSBC Group Compliance officer, responded: "4 SARs seems awfully indulgent, even by local standards. At any rate, it is against Group policy, as Susan [Wright] points out, so you will need to seek an official dispensation."<sup>265</sup> A "dispensation" was needed, because HSBC Group Policy No. GPP25 required accounts to be closed after two SARs were filed. The next day, HBMX informed HSBC Group Compliance that, rather than seek an official exception, it

<sup>259</sup> Id. 384.

<sup>260</sup> See September 2006 "Group Audit Mexico Audit Report Summary Schedule: GHQ Reportable Audits," for PFS Puebla Z01 C31 District Office (with 17 branches), PFS Puebla Z01 C23 District Office (17 branches), PFS Morelos Z01 A20 District Office (19 branches and 1 Module), and PFS Ciudad Juarez Z03 B02 District Office (21 branches and 1 custom module), HSBC OCC 8876717-720.

<sup>261</sup> Id.

<sup>262</sup> Id. at HSBC OCC 8876718.

<sup>263</sup> See 10/9/2006 email from HSBC David Bagley to HSBC John Root, forwarding message from HSBC Matthew King, "HBMX B/S and U Audit Report Summary for SEP06," HSBC OCC 8876715 (transmitting audit report summaries). See also August 2005 "General Audit Report: HBMX - PFS Torreon District (Z04 C01)," prepared by Group Audit Mexico, HSBC OCC 8876677-680 (finding a district office with 22 branches operating "Below Standard," with "[n]o significant progress ... since the previous audits and 11 repeat recommendations").

<sup>264</sup> See 10/17-18/2006 email exchanges among HBMX Ramon Garcia and Leopoldo Barroso and HSBC John Root, David Bagley, Susan Wright, and Emma Lawson, "2Q06 HBMX Compliance Report," and "Compliance with GPP 25," HSBC OCC 8876711-713.

<sup>265</sup> 10/17/2006 email from HSBC John Root to HBMX Ramon Garcia, with copies to HSBC David Bagley and Susan Wright, "2Q06 HBMX Compliance Report," HSBC OCC 8876713.

had decided to adopt the Group policy and would consider account closure after two SARS were filed, rather than four.<sup>266</sup>

**Unimed and Ye Gon Scandal.** In 2007, HBMX learned that one of its longstanding clients was accused of involvement with illegal drug trafficking. On March 15, 2007, in a joint effort with the U.S. Drug Enforcement Administration (DEA), the Mexican Government seized over \$205 million in U.S. dollars, \$17 million in Mexican pesos, firearms, and international wire transfer records from the residence of a wealthy Chinese-Mexican citizen, Zhenly Ye Gon.<sup>267</sup> The cash, which had been hidden in a secret locked room in the residence,<sup>268</sup> was described as the largest cash seizure in a drug-related case in history.<sup>269</sup>

Mr. Ye Gon, a prominent businessman, was the owner of three Mexican corporations involved in the pharmaceutical field, Unimed Pharm Chem Mexico S.A. de C.V.; Constructora e Inmobiliaria Federal S.A. de C.V.; and Unimed Pharmaceutical, S.A. de C.V.<sup>270</sup> He was accused of using his corporations to import, manufacture, and sell chemicals to drug cartels for use in manufacturing methamphetamine, an illegal drug sold in the United States.<sup>271</sup> He was also accused of displaying “significant unexplained wealth,” despite reporting no gross income for his companies for the years 2005, 2006, and 2007.<sup>272</sup> In June

<sup>266</sup> See 10/17-18/2006 email exchanges among HBMX Ramon Garcia and Leopoldo Barroso and HSBC John Root, David Bagley, Susan Wright, and Emma Lawson, “Compliance with GPP 25,” HSBC OCC 8876711-713. GPP 25 stated: “Where the customer is the subject of more than one validated suspicious transaction/activity report, then serious consideration should be given to closure of the relevant account/s and any other connected accounts.” Despite adopting the Group policy generally to close an account after two SARS, HBMX apparently did a poor job of implementation. In November 2007, Mr. Garcia revealed at an HSBC conference that HBMX had “numerous cases of accounts with multiple SARS (16 in one case!!) in Mexico that remain open.” In response, Ms. Wright asked Warren Leaming to “follow up with Ramon” to strengthen compliance with the Group policy on closing accounts with SARS. 11/16/2007 email from HSBC Susan Wright to HSBC Warren Leaming, copy to David Bagley, “Mexico,” HSBC OCC 8875423.

<sup>267</sup> See *In re Zhenly Ye Gon*, Case No. 1:07-cr-00181-EGS (USDC DC), Complaint for Arrest with a View Towards Extradition (9/15/2008) (hereinafter “Ye Gon Extradition Complaint”), at 13; “Mexican Fugitive and Co-Conspirator Arrested on U.S. Drug, Money Laundering Charges,” U.S. Drug Enforcement Administration press release (7/24/2007), <http://www.justice.gov/dea/pubs/states/newsrel/wdo072407.html>.

<sup>268</sup> See Ye Gon Extradition Complaint at 13.

<sup>269</sup> See, e.g., “Mexico seizes \$205.6M from luxury house,” Associated Press, Joan Grillo (3/22/2007).

<sup>270</sup> See Ye Gon Extradition Complaint at 6.

<sup>271</sup> Id. at 6-15; “Mexican Fugitive and Co-Conspirator Arrested on U.S. Drug, Money Laundering Charges,” U.S. Drug Enforcement Administration press release (7/24/2007), <http://www.justice.gov/dea/pubs/states/newsrel/wdo072407.html>. See also DEA testimony, “Violence Along the Southwest Border,” (3/24/2009), at 8, before the U.S. House Appropriations Subcommittee on Commerce, Justice, Science and Related Agencies (describing seizures from a “pharmaceutical company CEO who facilitated the importation of metric-ton quantities of ephedrine for the Sinaloa cartel’s methamphetamine-manufacturing operations”).

<sup>272</sup> Ye Gon Extradition Complaint at 12. The extradition complaint stated that in addition to transferring millions of dollars in U.S. currency abroad, Mr. Ye Gon engaged in a “lavish lifestyle, which included purchasing expensive cars and jewelry, and gambling (and losing a net sum of approximately \$125 million U.S. dollars) in Las Vegas, Nevada.” Id. at 12-13.

2007, Mr. Ye Gon was indicted in Mexico on drug, firearm, and money laundering charges, but could not be located.<sup>273</sup> In July 2007, he was arrested in the United States, imprisoned, and indicted by U.S. Federal prosecutors for aiding and abetting the manufacture of methamphetamine.<sup>274</sup> Two years later, in 2009, U.S. prosecutors dismissed the charges, after a witness recanted key testimony.<sup>275</sup> Mr. Ye Gon has remained imprisoned, however, subject to proceedings to extradite him to Mexico to stand trial.<sup>276</sup> Since his arrest, he has continually proclaimed his innocence.<sup>277</sup>

Mr. Ye Gon and his corporations were longtime clients of HBMX as well as other banks and casas de cambio in Mexico. One news article reported that the Mexican Ministry of Finance and Public Credit (SHCP) had determined that, from 2003 to 2006, Mr. Ye Gon and his companies moved \$90 million through 450 transactions involving four major Mexican banks, HBMX, Banamex, BBV Bancomer, and Banco Mercantil Del Norte, and multiple currency exchanges, including Casa De Cambio Puebla and Consultoria Internacional Casa De Cambio.<sup>278</sup>

The March 2007 seizure of cash and weapons from Mr. Ye Gon's residence triggered an intense review of his accounts by HBMX and HSBC Group.<sup>279</sup> According to internal HBMX documents, the Unimed accounts were opened by Bitel, retained by HBMX, and housed in HBMX's Personal Financial Services (PFS) division, even though the official clients were corporations and should not have been serviced by the PFS division.<sup>280</sup> The accounts were not designated as high risk, despite unusual transactions that had attracted bank attention several times from 2003 to 2007.<sup>281</sup> John Root told the Subcommittee that

<sup>273</sup> Ye Gon Extradition Complaint at 3-6 (describing Mexican Criminal Case No. 25/2007); "Mexican Fugitive and Co-Conspirator Arrested on U.S. Drug, Money Laundering Charges," U.S. Drug Enforcement Administration press release (7/24/2007), <http://www.justice.gov/dea/pubs/states/newsrel/wdo072407.html>.

<sup>274</sup> *In re Zhenli Ye Gon*, Case No. 1:07-cr-00181-EGS (USDC DC), Indictment (7/26/2007).

<sup>275</sup> See *id.*, Order (8/28/2009); "Mexico, the DEA, and the Case of Zhenli Ye Gon," *Washington Post*, Jorge Carrasco (10/29/2008), [http://www.washingtonpost.com/wp-dyn/content/article/2008/10/28/AR2008102801364\\_pf.html](http://www.washingtonpost.com/wp-dyn/content/article/2008/10/28/AR2008102801364_pf.html).

<sup>276</sup> See Ye Gon Extradition Complaint.

<sup>277</sup> See, e.g., "Mexico, the DEA, and the Case of Zhenli Ye Gon," *Washington Post*, Jorge Carrasco (10/29/2008), [http://www.washingtonpost.com/wp-dyn/content/article/2008/10/28/AR2008102801364\\_pf.html](http://www.washingtonpost.com/wp-dyn/content/article/2008/10/28/AR2008102801364_pf.html).

<sup>278</sup> 10/13/2007 "Reportan ruta de Ye Gon para 'blanquear' dinero" ("Ye Gon reported path to 'launder' money"), *El Universal*, Francisco Gómez, <http://www.eluniversal.com.mx/nacion/155016.html>, cited in 7/18/2008 Report of Findings (Update) for Consultoria Internacional Banco, prepared by HBUS Financial Intelligence Unit, HSBC OCC 1822420-434, at 422.

<sup>279</sup> See 4/19-20/2007 email exchanges among HBMX Paul Thurston, Sandy Flockhart, Graham Tomson, Ramon Garcia, and others and HSBC David Bagley, Matthew King, and others, "Management Letter: HBMX-[subject redacted by HSBC]," HSBC OCC 8875010-014.

<sup>280</sup> See 3/20/2007 email from HBMX Leopoldo Barroso to HSBC Paul Thurston, and others, "[subject redacted by HSBC]," HSBC OCC 8874315-16.

<sup>281</sup> See, e.g., 3/16/2007 email from HBMX Leopoldo Barroso to HSBC David Leighton and HBMX Ramon Garcia, "[subject redacted by HSBC]," HSBC OCC 8874317-318; 4/20/2007

during the 2003-2004 timeframe, the Unimed account had attracted the attention of HBMX regulators, and Susan Wright had instructed HBMX to terminate the relationship altogether.<sup>282</sup> He said that the HSBC Group did not realize the account was still open, until he and Ms. Wright saw the press articles regarding Unimed in 2007.

When the scandal broke, Paul Thurston, who had been appointed in February as HSBC Mexico CEO after the former head, Alexander Flockhart, was promoted, wrote: "This is a very serious, and high profile, case which has potential reputational damage to the HSBC Group, and must be given the highest priority."<sup>283</sup>

Mr. Thurston personally oversaw an extensive review of the accounts and HBMX's AML controls.<sup>284</sup> When the head of HSBC Latin American internal audits, Graham Thomson, was asked to summarize the AML deficiencies that contributed to the bank's maintaining such a high risk account, Mr. Thomson wrote in part:

"The main systemic weaknesses in HBMX, which I believe remain outstanding, are as follows:  
KYC as identified in branch and continuous audit reports.  
The lack of adequate documentation and filing systems which remain from the former Bital days ....  
Lack of a compliance culture ...."<sup>285</sup>

His criticisms about the lack of a compliance culture and poor KYC documentation echoed the criticisms made five years earlier, when HSBC first purchased Bital.

HBMX's internal review determined that, in 2005 and several times thereafter, concerns about suspicious activity involving the Unimed account had been brought to the attention of the HBMX Money Laundering Deterrence Communication and Control Committee (CCC Committee).<sup>286</sup> The CCC Committee apparently initially advocated

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email from HSBC Matthew King to HSBC Michael Geoghegan, and copy to David Bagley, "Managerial Letter: HBMX-[redacted by HSBC]," HSBC OCC 8874762.

<sup>282</sup> Subcommittee interview of John Root (4/26/2012).

<sup>283</sup> 3/20/2007 email from HBMX Paul Thurston to Leopoldo Barroso, Sandy Flockhart, and others, [subject redacted by HSBC], HSBC OCC 8874316-317.

<sup>284</sup> See, e.g., March and April 2007 email exchanges involving HBMX Paul Thurston and multiple HBMX and HSBC colleagues, "[subject redacted by HSBC]," HSBC OCC 8874315-326 and HSBC OCC 8875010-014.

<sup>285</sup> 4/2/2007 email from HBMX Graham Thomson to HSBC Matthew King and others, "Group Audit Committee – APR07," HSBC OCC 8874328-329.

<sup>286</sup> See, e.g., 4/20/2007 email from HBMX Graham Thomson to HSBC Matthew King and others, "Management Letter: HBMX-[subject redacted by HSBC]," HSBC OCC 8875010-011; 3/20/2007 email from HBMX Leopoldo Barroso to HBMX Paul Thurston and others, "[subject redacted by HSBC]," HSBC OCC 8874315-16; 3/16/2007 email from HBMX Leopoldo Barroso to HSBC David Leighton and HBMX Ramon Garcia, "[subject redacted by HSBC]," HSBC OCC 8874317-318.

closing the account, but then relented, in part because the Personal Financial Services (PFS) division where the account was located had, as one HBMX email put it, “argued that the client was fine, properly documented, and known by the business.”<sup>287</sup> The key PFS official who vouched for the client apparently later claimed he’d been “lied to” by other bank personnel.<sup>288</sup> The review also uncovered falsified “KYC visit reports,” documenting site visits to the client which had not actually taken place.<sup>289</sup> In addition, the review criticized poor analysis of the alerts which had spotted the “unusual” account activity.<sup>290</sup> One email noted that other Mexican banks with Unimed accounts “had not reported the customer to the authorities, despite hosting apparently unusual transactions similar in nature to those recorded by HBMX.”<sup>291</sup>

As a result of the Unimed scandal, Mr. Thurston developed seven action items to strengthen HBMX’s AML and KYC efforts.<sup>292</sup> They included reviewing the personnel assigned to the HBMX CCC committee and reminding CCC members of the need to take “an independent view” and to be “prepared to challenge their colleagues”; ensuring CCC minutes clearly identified the decisions taken; revamping KYC “analysis, assessment and reporting procedures” to ensure “higher risk cases are brought to senior management attention”; providing additional training on KYC assessment reports; transferring all corporations out of the Personal Financial Services division; and dismissing all branch staff involved with completing the falsified KYC reports.<sup>293</sup> Mr. Thurston also described the need to bring individual initiatives to improve KYC procedures, account opening and file maintenance into “one coherent programme” with “appropriate emphasis.”<sup>294</sup> In addition, he described holding a special CCC Committee meeting within a week to review cases with similar patterns

<sup>287</sup> 3/16/2007 email from HBMX Leopoldo Barroso to HSBC David Leighton and HBMX Ramon Garcia, “[subject redacted by HSBC],” HSBC OCC 8874317-318.

<sup>288</sup> 4/20/2007 email from HBMX Graham Thomson to HSBC Matthew King and others, “Management Letter: HBMX-[subject redacted by HSBC],” HSBC OCC 8875010-011. See also 4/18/2007 email from HSBC Matthew King to HBMX Graham Thomson, “Managerial Letter: HBMX-[redacted by HSBC],” HSBC OCC 8875013-014.

<sup>289</sup> See 4/20/2007 email from HBMX Graham Thomson to HSBC Matthew King and others, “Management Letter: HBMX-[subject redacted by HSBC],” HSBC OCC 8875010-011; 4/18/2007 email from HSBC Matthew King to HBMX Graham Thomson, “Managerial Letter: HBMX-[redacted by HSBC],” HSBC OCC 8875013-014; Subcommittee interview of Paul Thurston (5/1/2012).

<sup>290</sup> See 4/20/2007 email from HBMX Graham Thomson to HSBC Matthew King and others, “Management Letter: HBMX-[subject redacted by HSBC],” HSBC OCC 8875010-011; 4/18/2007 email from HSBC Matthew King to HBMX Graham Thomson, “Managerial Letter: HBMX-[redacted by HSBC],” HSBC OCC 8875013-014.

<sup>291</sup> 4/20/2007 email from HBMX Graham Thomson to HSBC Matthew King and others, “Management Letter: HBMX-[subject redacted by HSBC],” HSBC OCC 8875010-013.

<sup>292</sup> See 4/19/2007 email from Paul Thurston to multiple HBMX colleagues, “[subject redacted by HSBC],” HSBC OCC 8875011-014.

<sup>293</sup> Id. at HSBC OCC 8875012.

<sup>294</sup> Id.

and other high risk cases.<sup>295</sup> He also directed the internal audit group to conduct a review of HBMX's AML and CCC processes.<sup>296</sup>

The most senior levels of HSBC Group were kept informed about the case. On April 20, 2007, for example, Matthew King, head of HSBC Group Audits, sent an email to HSBC Group CEO Michael Geoghegan with this update:

"I am told the Mexican authorities are taking a relatively benign attitude to our involvement with this customer, which is fortunate because the review has revealed a number of weaknesses. A series of inaccurate, and possibly fabricated, visit reports seem to have been filed by the business which resisted any reporting of suspicions a number of times. For its part, the Moneylaundering Department failed to act as a proper check and balance. I have suggested a thorough review of processes within the Moneylaundering Department and of the Moneylaundering Committee to ensure they are robust. ... There are also a number of personnel decisions to be taken."<sup>297</sup>

Neither HBMX nor HSBC Group informed HBUS about the case.<sup>298</sup>

The Unimed scandal broke nearly five years after HSBC first began working to strengthen HBMX's AML controls and create a compliance culture. It showed that, while progress had been made, HBMX still had multiple AML deficiencies and a poor compliance culture.

**2007 AML Efforts.** For the rest of 2007, HSBC Group Compliance devoted attention and resources to strengthening AML controls at HBMX, with limited success.

One step taken was to task the new HBMX Chief Operating Officer, John Rendall, with overseeing HBMX's KYC remediation effort for existing client files, an effort mandated by CNBV authorities but far behind schedule.<sup>299</sup> Mexican regulators had given Mexican banks until 2007, to update the KYC information in all customer files;

<sup>295</sup> Id. at HSBC OCC 8875012-13. HBMX did not identify any other corporate clients with a similar profile. Subcommittee interview of Paul Thurston (5/1/2012).

<sup>296</sup> This review produced an audit report in December 2007, discussed below. See Dec. 2007 "General & Transactional Banking Audit: HBMX – Money Laundering Deterrence," prepared by Group Audit Mexico, HSBC OCC 8874802-810.

<sup>297</sup> 4/20/2007 email from HSBC Matthew King to HSBC Michael Geoghegan, and copy to David Bagley, "Managerial Letter: HBMX-[redacted by HSBC]," HSBC OCC 8874762.

<sup>298</sup> Subcommittee interview of Paul Thurston (5/1/2012).

<sup>299</sup> See, e.g., 2/27/2008 email from HBMX Paul Thurston to HSBC Michael Geoghegan and others, "CNBV/FIU Update," HSBC-PSI-PROD-0198510-511.

HBMX had obtained an extension until May 2008, but expected to be hard pressed to meet the new deadline.<sup>300</sup>

In June 2007, David Bagley, HSBC Group Compliance head, visited HBMX for several days, met with CNBV officials, and circulated a report on the outstanding compliance and AML issues. In an email transmitting his report, Mr. Bagley wrote:

“[T]here do appear to be a number of issues to be resolved, particularly those relating to accurate ongoing account opening, prompt effective and complete remediation in accordance with CNBV requirements for existing accounts, and completion of the recommended enhancements to the working of the MLD committee. ... [W]e will need on an ongoing basis to consider the nature and extent of the resources currently available in CMP [Compliance]. ... I suspect we are already stretched given the apparent growth that has already, or is intended to take place in this area which appears to be growth of both volume and complexity.”<sup>301</sup>

His five-page report detailed a number of compliance and AML problems.<sup>302</sup> First was HBMX’s anticipated failure to meet a Mexican regulatory deadline for reviewing the KYC information for all existing accounts to ensure compliance with regulatory requirements. The report noted: “There appeared to be differing opinions as to how many accounts were affected, how many accounts were outstanding and therefore no real tracking of the progress being made.” The report recommended reaching a consensus on the method for tracking accounts and completing the task. The report also expressed concern about KYC weaknesses in opening new accounts. It noted: “If we are opening new accounts badly it will only add to the remediation exercise required by CNBV .... Accurate and complete account opening is a key AML control, particularly in emerging markets.” A third key issue was “confusion as to the stated aims and purpose of the MLD Committee.” A fourth was that “the CAMP monitoring system produces significant numbers of ‘false’ alerts. This is a feature of all AML monitoring

<sup>300</sup> See 7/27/2007 minutes of LAM Regional Audit Committee, HSBC OCC 8875086-088, at 3 (“CNBV has granted a 1-year extension to MAY08 for HBMX to regularize customer identification files for account[s] opened or contracts signed before MAY04.”); 12/2007 audit of “HBMX-Money Laundering Deterrence (MLD),” No. HBMX GAQ 070086, prepared by HSBC Group Audit, Executive Summary, HSBC OCC 8876347 (“HBMX has been given an extension by the Regulator from May 07 to May 08 to ensure that a portion of the client files (known as the UBA project – about 1.8m customers) are completed.”).

<sup>301</sup> 6/27/2007 email from HSBC David Bagley to HBMX Paul Thurston and others, “Visit Report,” HSBC OCC 8874967-968. Mr. Bagley visited Mexico and Panama from June 11 to June 14, 2007. See 7/27/2007 Minutes of LAM Regional Audit Committee, HSBC OCC 8875086-090, at 3.

<sup>302</sup> June 2007 “Summary of Compliance Issues – Mexico,” report prepared by David Bagley, HSBC OCC 8874970-974.

systems. Having said this, steps are being taken across the Group to seek to minimize this,” and recommended that similar steps be taken in Mexico. A fifth concern was that the compliance team was “lightly resourced.”

The report also discussed a “cordial” meeting held with CNBV regulators. It said that the regulators were “overall extremely positive about the bank” but also “had a fairly lengthy list of issues,” most of which focused on compliance matters other than AML issues.<sup>303</sup> Paul Thurston, head of HSBC Mexico, thanked Mr. Bagley for the “constructive report.” He wrote:

“I agree with your comment that we need to review the role and resources in the Compliance function. ... For all Ramon’s strengths, I have equally seen weaknesses in addressing key issues ... and in my view the jury is out on his ability to do all that we need in HBMX, let alone try to oversee other countries in the region. ... [W]e should review between the three of us in a few month’s time, when we see what progress is being made.”<sup>304</sup>

The very next month, July 2007, John Root, a senior HSBC Group Compliance officer, sent a blistering email to Ramon Garcia condemning HBMX’s CCC Committee for “rubber-stamping unacceptable risks”:

“A number of items jump out from your most recently weekly report (02JUL-06JUL) but everything pales in comparison with the ML items on page 4. It looks like the business is still retaining unacceptable risks and the AML committee is going along after some initial hemming and hawing. I am quite concerned that the committee is not functioning properly. Alarmed, even. I am close to picking up the phone to your CEO.

[Redacted by HSBC] looks like another [Unimed<sup>305</sup>] type of situation – what on earth is an ‘assumption responsibility letter’ and how would it protect the bank if the client is a money launderer? Please note that you can dress up the USD10 million to be paid ... to the US authorities as an ‘economic penalty’ if you wish but a fine is a fine is a fine, and a hefty one at that. What is this, the School of Low Expectations Banking? (“We didn’t go to jail! We merely signed a settlement with the Feds for \$ 10 million!”) ...

<sup>303</sup> Id. at 3.

<sup>304</sup> 6/29/2007 email from HBMX Paul Thurston to HSBC David Bagley and John Rendall, “Visit Report,” HSBC OCC 8874965.

<sup>305</sup> Although the client name was redacted from the document by HSBC, John Root confirmed that Mr. Thurston was referring to Unimed. Subcommittee interview of John Root (4/26/2012).



So, [Unimed<sup>306</sup>] is strike one. [Redacted by HSBC] is strike two. Let's now look at strike three. (I hope you like baseball.)

The same person who is giving the sancrosanct 'assumption responsibility letter' for [Redacted by HSBC] ... is being asked by the CEO to explain why he retained the [Casa De Cambio Puebla<sup>307</sup>] relationship after USC11 million was seized by the authority in [Puebla<sup>308</sup>] account with Wachovia in Miami. What?! The business was okay with this?

The AML Committee just can't keep rubber-stamping unacceptable risks merely because someone on the business side writes a nice letter. It needs to take a firmer stand. It needs some cojones. We have seen this movie before, and it ends badly."<sup>309</sup>

Mr. Garcia responded that he was escalating the two cases involving high risk clients as part of a revised AML procedure in the CCC Committee.<sup>310</sup> He explained that Mexican law essentially required the CCC committee to give great weight to the opinion of the business side of the bank, because "they are the ones that really know the customer." He said that he had escalated the cases to the HBMX CEO, because MLD had "a different opinion" from the business "about reporting the case to authorities." Essentially, he said that the final decision belonged to the HBMX CEO, rather than the CCC Committee.

The next week, Paul Thurston, HSBC Mexico CEO, supported the CCC Committee's recommendation to close one of the accounts, but not the other. He supported closing the account of Casa de Cambio Puebla, which had been a client for more than 20 years, but whose funds at Wachovia Bank had been seized by the U.S. Justice Department and Drug Enforcement Administration (DEA).<sup>311</sup> Mr. Thurston cautioned John Rendall, the HBMX Chief Operating Officer, to alert CNBV and to ensure CNBV had "no objection."<sup>312</sup> Mr. Rendall also suggested alerting their U.S. counterparts since HBUS had the same relationship with the client.<sup>313</sup> The second account involved a U.S. money services

<sup>306</sup> Id.

<sup>307</sup> Although the client name was redacted from the document by HSBC, the reference to a seizure of \$11 million from Wachovia Bank in Miami indicates that the client is Casa de Cambio Puebla. See discussion below.

<sup>308</sup> Id.

<sup>309</sup> 7/17/2007 email from HSBC John Root to HBMX Ramon Garcia, with copies to Susan Wright, David Bagley, and Warren Leaming, "Weekly Compliance Report 02JUL-06JUL07," HSBC OCC 8875925-927.

<sup>310</sup> 7/18/2007 email from Ramon Garcia to HBC David Bagley, "Weekly Compliance Report 02JUL-06JUL07," HSBC OCC 8875925.

<sup>311</sup> See July 2007 email exchanges among HBMX Paul Thurston, John Rendall, Ramon Garcia, and others, "[subject redacted by HSBC], HSBC OCC 8875132-135.

<sup>312</sup> Id. at 132.

<sup>313</sup> Id.

business, Sigue Corporation, which specialized in remitting funds from the United States to Mexico and Latin America. Mr. Thurston, on the advice of Mr. Rendall and the commercial banking division, kept that account open.<sup>314</sup>

Later in July, the HSBC Latin American (LAM) Regional Audit Committee held a meeting in Mexico.<sup>315</sup> Participants included HSBC Group Compliance officials Brian Robertson, David Bagley, and Matthew King; LAM/HBMX officials Paul Thurston, Emilson Alonso, and Graham Thomson; HBMX Compliance head Ramon Garcia; and others from HSBC affiliates throughout Latin America. Mr. Thomson, head of LAM Internal Audit, discussed risk and compliance issues in several countries, and noted that Regional CEOs were now required to “take disciplinary action should a manager record 2 consecutive Below Standard control risk assessments or record significant repeat recommendations.”<sup>316</sup> With respect to Mexico, Mr. Thomson noted that although 96% of HBMX electronic records reportedly met regulatory requirements, there was a “high level of exceptions and variance between the paper and electronic records” which would require “a large rectification effort” to meet the regulatory deadline of May 2008.<sup>317</sup> He also noted that branch offices were not sufficiently familiar with SCC requirements, and criticized the CCC Committee for failing to followup on instructions to close client accounts. Mr. Thurston noted that the CCC Committee was introducing an escalation process to senior management to resolve disputes over closing accounts.<sup>318</sup> Ramon Garcia also reported that automation problems were causing delays in the issuance of Suspicious Activity Reports (SARs), but that interim manual reviews had not detected activity requiring any SARs to be filed.<sup>319</sup> He also described a new pilot project at 94 HBMX branches to centralize management and control of account documentation using electronically imaged documents.

**CNBV Escalates Concerns.** Two months later, in October 2007, the CNBV asked to meet with Paul Thurston, the HSBC Mexico CEO, to express ongoing concerns about HBMX’s compliance and AML

<sup>314</sup> See 2/4/2008 email from HBMX John Rendall to HBMX Paul Thurston, “[redacted by HSBC],” HSBC OCC 8875139-141 and HSBC OCC 8875020-021. Six months later, in January 2008, Sigue Corporation entered into a deferred prosecution agreement with the U.S. Justice Department, admitting that some of its agents had been laundering drug proceeds. See United States v. Sigue Corp. and Sigue LLC, Case No. 4:08CR54 (USDC EDMO), Deferred Prosecution Agreement Factual Statement (1/28/2008). HBMX’s relationship with Sigue Corporation is discussed further below.

<sup>315</sup> See 7/27/2007 Minutes of LAM Regional Audit Committee, HSBC OCC 8875086-090.

<sup>316</sup> Id. at 2.

<sup>317</sup> Id.

<sup>318</sup> Id. Mr. Thurston explained that if compliance and business personnel disagreed over closing an account, the dispute would be escalated to the HBMX COO, and then to the CEO. In addition if a business wanted to close an account, a higher ranking Executive Director would have to make the decision. Subcommittee interview of Paul Thurston (5/1/2012).

<sup>319</sup> Id. at 3.

efforts. Mr. Thurston summarized the meeting in an email to the HSBC Group CEO Michael Geoghegan.<sup>320</sup> He wrote:

“At their request, I met today with the Head of Banking Supervision, and the Supervisor for HSBC, from our regulator, the CNBV, following their on site examination of various aspects of our business, including cards, money laundering, and treasury operations. ...

They walked me through a presentation pack which firstly set out specific points ... but then moved on to more general concerns of the CNBV with HSBC in Mexico. These centered on:

- weaknesses in internal controls ... slow progress in tackling KYC data problems and anti money laundering procedures.
- corporate culture, where they comment that ... HSBC has driven growth in credit products and launched new products without adequate controls. ...

They also expressed concerns at senior management having dual responsibilities for Mexico and the region, stating that ‘there are many concerns on how management will be able to implement strong controls within the bank in Mexico, while keeping an eye on other countries.’ ...

I indicated to them we were aware of these issues and were progressively tackling them.”<sup>321</sup>

His email then outlined the steps he told CNBV that HBMX was taking, including new hires, “customer file centralizing and imaging which would give us more robust KYC data for anti-money laundering,” and working to change the culture of the bank which “would not happen over night.”<sup>322</sup> Mr. Thurston wrote that the CNBV officials told him that was “what they wanted to hear and that they would report back positively” to the head of the CNBV. Mr. Geoghegan responded: “This is disturbing and clearly we will need to look at the management structure and practices. ... I am copying this to the Group Chairman and Matthew King for their information.”<sup>323</sup>

<sup>320</sup> 10/23/2007 email exchange between HBMX Paul Thurston and HSBC Michael Geoghegan, “CNBV Inspection,” HSBC OCC 8873338-342.

<sup>321</sup> Id.

<sup>322</sup> Id. at HSBC-OC-8873341.

<sup>323</sup> Id. at HSBC-OC-8873338.

In December 2007, the internal audit group for Mexico issued a report that had been ordered earlier on HBMX's AML efforts.<sup>324</sup> It found HBMX's AML controls to be "Below Standard" and to pose an overall "high" risk.<sup>325</sup> It detailed multiple problems, including "[r]egulatory breaches in KYC issues such as the large number of incomplete client files and the inadequate process of SCC identification and monitoring across the network."<sup>326</sup> It noted that HBMX had a May 2008 deadline for bringing files into compliance with KYC regulations set by the CNBV, and that regulators had been told 86% of client files already met regulatory requirements, while audit work over the past year suggested a much lower percentage, "as low as 46%." The audit report also noted that the KYC effort was remediating only 1.8 million files involving high risk, excluding another almost 6 million clients "that the Group has in Mexico which are subject to HSBC's own MLD policies."<sup>327</sup>

The 2007 audit report also disclosed SAR filing and alert review backlogs. It noted "4,890 accounts that reported unusual transactions that took place between APR [April] and AUG07," but which had yet to be reported to Mexican authorities, "thereby breaching the regulations."<sup>328</sup> It attributed the delay to changed internal criteria for reporting transactions, resulting in an increase in the number of cases to be reported, and "slow decision-making."<sup>329</sup> The report also noted 7,217 alert warnings of which 858 (12%) had not been reviewed at all, "posing a potential risk that criminal transactions may not be identified which may have an adverse reputational effect on the Institution."<sup>330</sup> The audit report stated that the failure to review these alerts had been going on for one year due to "insufficient Operations staffing." The report also criticized "Senior Management" for attending few AML committee meetings, delaying decisions on cancelling accounts, and delaying the imposition of sanctions when cases were not reported to the CNBV on time.<sup>331</sup> The report also noted a lack of "sufficient understanding" of the AML IT systems and inadequate AML training as evidenced by the "failures regularly identified in branch audits."<sup>332</sup> In light of the "number and in many cases seriousness of the weaknesses identified," the report recommended creating an HBMX Money Laundering Committee to undertake the effort needed to address the widespread AML shortcomings.

<sup>324</sup> See 12/2007 "General & Transactional Banking Audit: HBMX – Money Laundering Deterrence," No. HBMX GAQ 070086, prepared by Group Audit Mexico, HSBC OCC 8874802-810.

<sup>325</sup> Id. at HSBC OCC 8874810.

<sup>326</sup> Id.

<sup>327</sup> Id.

<sup>328</sup> Id. at HSBC OCC 8874807.

<sup>329</sup> Id. at HSBC OCC 8874807, 810.

<sup>330</sup> Id. at HSBC OCC 8874808.

<sup>331</sup> Id. at HSBC OCC 8874807.

<sup>332</sup> Id. at HSBC OCC 8874810.

Confronted by this long list of AML deficiencies, HSBC Group sent Warren Leaming, HSBC Group Compliance Deputy Head, to Mexico to help determine what should be done.<sup>333</sup>

**CNBV and FIU Dissatisfaction Deepens.** As 2007 drew to a close, HSBC Group and HBMX worked to strengthen HBMX's AML efforts, but CNBV dissatisfaction with the bank seemed to deepen and the list of AML concerns broaden in 2008, encompassing for the first time concerns about HBMX's participation in bulk cash services.

In February 2008, Mr. Thurston, HSBC Mexico CEO, met again with CNBV officials, at their request, along with the Mexican Financial Intelligence Unit (FIU).<sup>334</sup> According to an email he sent summarizing the meeting, CNBV handed him a draft report detailing multiple compliance concerns.<sup>335</sup> Mr. Thurston wrote:

"It is clear in this that our Head of Compliance is not as highly regarded by the CNBV as had been thought by local and Group management, and indeed appears to have misled us about the extent to which the CNBV have been informed of, and/or are satisfied with, our actions."<sup>336</sup>

HSBC Group CEO Geoghegan responded: "This is most disturbing and we will need to have the most thorough of investigations."<sup>337</sup>

The report provided by the CNBV stated that "[a]s a result of the increase in bank's operations, there has been an increase in deficiencies in internal control."<sup>338</sup> It described a variety of problems. With respect to AML issues, the report concluded that "little improvement" in AML controls had occurred since the prior year's on-site inspection.<sup>339</sup> It noted that, of 110 client files reviewed, "55 files (50%) were incomplete," and 5 files were not provided at all. It noted a "[l]ack of closer supervision to high profile risk clients"; a lack of risk criteria to

<sup>333</sup> See, e.g., 12/6/2007 email from HSBC John Root to HSBC Warren Leaming and others, "Warren Leaming HBMX DEC Visit Issues," HSBC OCC 8875837 ("I am keeping a list of issues that you might want to raise during your December visit to HBMX," including deteriorating audits of treasury operations, resourcing concerns, "Sinaloa massive money-laundering scheme (+USD 100 million)," "HBMX Trusts backlog," "Banistmo business in regulatory and tax havens," and "AML systems integration").

<sup>334</sup> See 2/18/2008 email from HBMX Paul Thurston to HSBC Michael Geoghegan, with copies to Richard Bennett and Matthew King, "Confidential – CMBV/FIU Meeting," HSBC OCC 8873331-333.

<sup>335</sup> Id. at HSBC OCC 8873333.

<sup>336</sup> 2/18/2008 draft report entitled, "Internal Control, HBC Mexico, S.A.," prepared by CNBV, HSBC OCC 8966021-026, at 6. [Sealed Exhibit.]

<sup>337</sup> 2/18/2008 email from HSBC Michael Geoghegan to HBMX Paul Thurston and others, including HSBC Group Chairman Stephen Green, "Confidential – CMBV/FIU Meeting," HSBC OCC 8873331.

<sup>338</sup> 2/18/2008 draft report entitled, "Internal Control, HBC Mexico, S.A.," prepared by CNBV, HSBC OCC 8966021-026, at 1. [Sealed Exhibit.]

<sup>339</sup> Id. at 2.

classify clients during the account opening process; and missing client updates for high risk customers and politically exposed persons.<sup>340</sup> Another deficiency was that the CAMP and HOGAN monitoring systems did not collect transaction profiles for new accounts, as required by law, and the CCC Committee delayed closing suspicious accounts, citing the example of a \$2.8 million account kept open for an entire year after it was supposed to be closed.<sup>341</sup>

The report also described a number of AML deficiencies identified by the FIU, stating: "Evidence obtained by the Financial Intelligence Unit of Mexico (UIF) on a frequent basis has seriously raised its concern on the very high level of ML risk that HSBC may be incurring."<sup>342</sup> It provided a chart showing that HSBC had much more bulk cash transactions using U.S. dollars than other Mexican banks, and expressed U.S. and Mexican law enforcement concern that the cash represented illegal drug sale proceeds from the United States.<sup>343</sup> The FIU also noted that HBMX frequently failed to provide requested information, claiming the files or basic account documents could not be located, providing a chart showing HBMX's response record was worse than other Mexican banks.<sup>344</sup> The FIU also noted that "in the majority of the most relevant ML cases" it had investigated in 2007, "many transactions were carried out through HSBC," and in some cases, the FIU detected ML transactions that HSBC had not reported.<sup>345</sup> The FIU also noted that it had been able to obtain copies of account documents that HBMX had claimed it could not locate. "These last cases may imply criminal responsibility of HSBC and its personnel – such as that relating to false statements to administrative authorities and complicity – that the law enforcement and judicial authorities must investigate."<sup>346</sup>

Internal HBMX and HSBC Group documents indicate that senior management immediately began to investigate the allegations. HSBC Group CEO Michael Geoghegan spoke to HSBC Group Chairman Stephen Green, as well as senior HSBC Group and HBMX personnel, and asked David Bagley to lead the review of HBMX Compliance.<sup>347</sup> Mr. Bagley left for Mexico immediately for a two-week stay. Mr. Thurston directed the head of Latin American Security to investigate certain allegations, and the head of Latin American internal audit to

<sup>340</sup> Id. at 3.

<sup>341</sup> Id.

<sup>342</sup> Id. at 5.

<sup>343</sup> Id.

<sup>344</sup> Id. at 5-6.

<sup>345</sup> Id. at 6. Recent examples of such cases included Zhenly Ye Gon, Casa de Cambio Puebla, and Sigue Corporation.

<sup>346</sup> Id.

<sup>347</sup> 2/19/2008 email from HSBC Michael Geoghegan to Paul Thurston, Richard Bennett, Matthew King, with copies to Stephen Green and David Bagley, "HBMX – ML Review," HSBC-PSI-PROD-0198506-507.

examine the other CNBV and FIU complaints.<sup>348</sup> Mr. Thurston promised an updated report to Mr. Geoghegan prior to an upcoming HSBC Group Board meeting.

Three days later, on February 22, 2008, Matthew King composed a draft email as a way to organize the information that should be conveyed to Mr. Geoghegan in a telephone call, and circulated his self-described “brain dump” to Messrs. Thurston, Bagley, Bennett, and Graham Thomson for their thoughts.<sup>349</sup> The email indicated that the AML concerns raised by the CNBV were “pretty similar” to issues raised earlier, but the CNBV had “suddenly become more aggressive.” The email speculated on whether that was due to political pressure, FIU concerns, or possibly a separate disagreement with the FIU regarding reimbursing a public utility for a fraud. Mr. King also wrote: “It is also the case that Mexico is suffering a major problem with drugs dealers and the Government is being very robust about dealing with them.”

The King email then went through the issues. It noted that the December 2007 internal AML audit of HBMX was “Below Standard,” and that the AML Director Leopoldo Barroso would be replaced, “albeit the FIU apparently regard him as trustworthy” so his replacement would have to be “carefully explained.”<sup>350</sup> The email said that the “biggest immediate concern” was account KYC, which had been “a systematic problem for some time.” Among other matters, the email noted that a pilot project to centralize account documentation through electronic imaging was underway, but “Audit is continuing to identify a high level of exceptions for that process also (around 30%).”<sup>351</sup> Mr. King wrote:

“Given the concerns now raised by the CNBV and FIU (which apparently includes tapes of a drug lord recommending HBMX as the place to bank) we now have to decide: whether the imaging process can be made to work to everyone’s satisfaction[;] how quickly it can be rolled ou[t] across the whole network[; and] in the meantime, whether we can continue to open accounts using the old, flawed process.”<sup>352</sup>

The email also described account documentation as “a problem since we bought Bitai,” and noted that CNBV had again questioned having

<sup>348</sup> 2/19/2008 email from HBMX Paul Thurston to HSBC Michael Geoghegan and others, “HBMX – ML Review,” HSBC-PSI-PROD-0198505-506.

<sup>349</sup> 2/22/2008 email from HSBC Matthew King to HBMX Paul Thurston, HBMX Graham Thomson, with copies to HSBC Richard Bennett and HSBC David Bagley, “CNBV,” HSBC-PSI-PROD-0198508-509.

<sup>350</sup> Id. at 1.

<sup>351</sup> Id.

<sup>352</sup> Id. at 1-2. Both David Bagley and Paul Thurston told the Subcommittee that they asked the CNBV for a copy of the purported tapes, but none was provided. Subcommittee interviews of David Bagley (5/10/2012) and Paul Thurston (5/1/2012).

HBMX personnel handle compliance issues for the Latin American region in addition to Mexico.<sup>353</sup> On “cross-border cash,” the email indicated that trends still needed to be clarified, but he thought the United States had “a general concern rather than a specific one about us.”

The next day, February 23, 2008, Paul Thurston sent an email to Michael Geoghegan with additional information. He wrote:

“Firstly, to answer your question of why is this being raised now? The intelligence that we have been able to gather is that with President Felipe Calderon declaring war on the drugs gangs, crime and corruption the judicial authorities have heightened the focus on financial investigations and have been putting increasing pressure on the bank regulators because the banks have been seen as not providing good enough support. ... HSBC has historically, and continues to have, a worse record than the other banks, so we have become a focus of attention. The new Head of the FIU has told us that his staff have told him that HSBC has been the most difficult bank to obtain accurate and timely data from for the past 4 years.”<sup>354</sup>

Mr. Thurston wrote that HBMX had taken more corrective action than the regulators were aware of.<sup>355</sup> He acknowledged an account documentation problem which would be addressed, in part, by a new centralized electronic imaging procedure which was taking effect Mexico-wide that month. In addition, he wrote that “stronger disciplinary procedures” were being put in place for branch managers who signed off on account openings without personally ensuring all documents were obtained.<sup>356</sup> He also noted that HBMX received more than 1,000 letters per week from the CNBV asking for account information, and that more resources had to be dedicated to responding to them.

Finally, on the bulk cash issue, Mr. Thurston wrote that the United States had a general concern, “not aimed specifically at HSBC,” about the flow of U.S. banknotes from Mexico and the potential linkage to drug related activity.<sup>357</sup> He wrote that HBMX had undertaken its own analysis of the cash flows, and initial indications were that its handling

<sup>353</sup> Id. at 2.

<sup>354</sup> 2/23/2008 email from HBMX Paul Thurston to HSBC Michael Geoghegan, with copies to Stephen Green, Matthew King, Richard Bennet, and David Bagley, “CNBV/FIU Update,” HSBC-PSI-PROD-0197872-873.

<sup>355</sup> Id. at 1.

<sup>356</sup> Id. at 1-2.

<sup>357</sup> Id. at 2.



of U.S. dollars “had been slowly declining in recent years, rather than rising.”<sup>358</sup>

On February 27, 2008, Mr. Bagley conducted an exit interview with the HBMX AML Director Leopoldo R. Barroso, who was being replaced. Mr. Barroso provided a negative view of HBMX AML performance. According to a meeting summary written by Mr. Bagley, Mr. Barroso said that, while in his position, he had felt civil and criminal “litigation exposure” due to “the continued poor controls in the bank, the fact that there were allegations of 60% to 70% of laundered proceeds in Mexico went through HBMX and because he did not think that senior management had any commitment to robust AML controls.”<sup>359</sup> Mr. Barroso indicated that “it was only a matter of time before the bank faced criminal sanctions and cited a number of cases.” Mr. Bagley wrote:

“It was clear that LRB [Leopoldo R. Barroso] felt very strongly that relevant business heads within HBMX had absolutely no respect for AML controls and the risks to which the Group was exposed and had no intention of applying sensible or appropriate approaches. Again he cited a number of examples where despite strong recommendations with the CMP [Compliance] business heads had failed or refused to close accounts or indeed on occasions file SARs. He thought that there was a culture that pursuing profit and targets at all costs and in fact had seen no recent improvement in the standard of controls or the types of decisions being taken.

He was critical of the level of resources in his team and felt that his team had done much to keep the bank out of trouble by working extra hours against impossible deadlines and handling significant volumes of alerts including those from CAMP. ...

[H]e thought he needed at least 35 new headcount. ...

He was extremely critical of RG [Ramon Garcia] who he described as being indecisive, weak and desperate to retain his job and lacking any understanding of AML matters.”<sup>360</sup>

Mr. Bagley later forwarded his summary of the meeting to Mr. Thurston who responded that “the jury is still out on Ramon” and a

<sup>358</sup> See also 2/27/2008 email exchange between HBMX Paul Thurston and HSBC Michael Geoghegan, “CNBV/FIU Update,” HSBC-PSI-PROD-0198510-512.

<sup>359</sup> 2/27/2008 “Meeting Attendance Note,” prepared by David Bagley, HSBC OCC 8874824-

825.  
<sup>360</sup> Id.

discussion was needed on structuring the Latin American regional and Mexican compliance responsibilities.<sup>361</sup>

On March 3, 2008, HBMX issued a 12-page response to the internal control issues raised by the CNBV in its draft report of February 27.<sup>362</sup> The response detailed multiple “corrective actions” being taken by the bank to address each concern. Among the actions discussed were the new centralized process for ensuring account opening documentation was obtained and electronically recorded; a new effort to centralize PEP files, obtain missing documentation, and strengthen annual PEP reviews; new disciplinary procedures for opening accounts with incomplete documentation; the re-engineering and strengthening of the alert reporting process; replacement of the AML director; and strengthening of the AML staff. The response also indicated that management changes had been made to split responsibilities for Mexico from the rest of the Latin American region. On the issue of U.S. banknotes, the response indicated that HBMX U.S. dollar volumes had not increased, but were marginally lower than in 2003. It also announced a new policy, effective immediately, to deem all customers who deposit more than \$100,000 in a month as SCC clients subject to enhanced due diligence. The response said that 312 customers met that criteria and were being subjected to a KYC review.

Mr. Thurston and Mr. Bagley met with CNBV and FIU officials on March 4, 2008, to deliver the response and discuss the bank’s actions. They reported to Mr. Geoghegan that the meeting was “extremely cordial” and the bank’s corrective efforts were “well received.”<sup>363</sup> After Mr. Bagley returned to London, he also discussed the matter with the Financial Services Authority (FSA), HSBC’s UK regulator, which had communicated with CNBV. Mr. Bagley reported that “CNBV confirmed that they were satisfied with the reaction and steps we have taken although will watch implementation closely.”<sup>364</sup> In April 2008, at a meeting of the HSBC Group Board of Directors, Mr. Bagley briefed the HSBC Group Audit Committee about HBMX, indicating that regulators had “expressed their satisfaction with the Group’s reaction.”<sup>365</sup>

**Restoration Project.** HBMX spent the next six months working to carry out the corrective actions outlined in its March response to

<sup>361</sup> 3/7/2008 email exchange among HSBC David Bagley and HBMX Paul Thurston and John Rendall, “HBMX,” HSBC OCC 8874821-822.

<sup>362</sup> 3/3/2008 “Internal Control, HSBC Mexico SA,” prepared by HBMX, HSBC OCC 8966027-038.

<sup>363</sup> 3/5/2008 email from HSBC David Bagley to HSBC Michael Geoghegan and others, “CNBV/FIU Meeting,” HSBC-PSI-PROD-0198513.

<sup>364</sup> 3/15/2008 email from HSBC David Bagley to HBMX Paul Thurston and others, “CNBV,” HSBC OCC 8875171.

<sup>365</sup> 4/25/2008 Board of Directors minutes for HSBC Holdings plc, HSBC-PSI-PROD-0198539-540.

CNBV. HBMX also underwent personnel changes. In May 2008, Paul Thurston was promoted and returned to London, having spent a little more than one year in Mexico. Luis Pena Kegel took over as HSBC Mexico CEO and head of HBMX. Emilson Alonso was appointed head of HSBC Latin America, carrying out the commitment made to CNBV to split the two sets of responsibilities. In the summer of 2008, a new HBMX AML director was also hired, Jaime Saenz.<sup>366</sup>

One key AML activity undertaken by the bank was to work on bringing the KYC documentation for existing accounts into compliance with CNBV requirements, an effort HBMX deemed “Proyecto Restauracion” or the Restoration Project. HBMX was supposed to have completed the KYC effort by May 2008, after having obtained a one-year extension, but was far behind schedule. HBMX appointed John Rendall, HBMX COO, to oversee the new project. One step he took was to limit the project to high risk accounts.<sup>367</sup> He also assembled a team and began pressing branch personnel to complete their KYC updates. John Root, a senior HSBC Group Compliance officer, attended a meeting of the Restoration Project team during a visit to Mexico in July, and was “very impressed” by the progress to date.<sup>368</sup>

Also in July 2008, Mr. Rendall provided a progress report to the Latin American regional audit committee on a number of AML and compliance efforts, outlining “9 workstreams.” He described several milestones, including implementing the centralized account opening process for all HBMX branches, initiating the KYC Restoration Project “focused on high risk accounts,” achieving a “90% reduction (from 34,700 to 3,300)” in the 2008 CAMP alert backlog, requiring enhanced KYC for customers with over \$100,000 in U.S. dollar deposits, and improving FIU response procedures.<sup>369</sup>

On a more negative note in July, HBMX’s internal monitoring system generated a number of alerts identifying “significant USD [U.S. dollar] remittances being made by a number of customers to a US company alleged to have been involved in the supply of aircraft to drugs cartels.”<sup>370</sup> The alerts highlighted account activity in the HBMX Cayman branch.<sup>371</sup> As a “precaution” pending review of the account activity, HBMX stopped opening new Cayman accounts.<sup>372</sup> The account

<sup>366</sup> See 7/30/2008 email from HSBC John Root to HSBC David Bagley and others, “HBMX Visit Update,” HSBC OCC 8873487-489.

<sup>367</sup> See 6/7/2010 email from HBUS Paul Lawrence to HSBC Michael Geoghegan, “Mexico Banknotes/High-level Timeline,” HSBC-PSI-PROD-0198514-516.

<sup>368</sup> Id.

<sup>369</sup> See 6/7/2010 email from HBUS Paul Lawrence to HSBC Michael Geoghegan, “Mexico Banknotes/High-level Timeline,” HSBC-PSI-PROD-0198514-516.

<sup>370</sup> 7/31/2008 email from HSBC David Bagley to HSBC Richard Bennett with copies to HSBC Michael Geoghegan and others, “HBMX – Cayman Accounts,” HSBC OCC 8874832-833.

<sup>371</sup> Id.

<sup>372</sup> Id.

activity also prompted HSBC Group to take a closer look at the Cayman accounts.<sup>373</sup> HSBC Group Compliance head David Bagley wrote that the Cayman accounts should be included in the Restoration Project “as a priority area,” and should “be seen as high-risk from an AML and reputational perspective.”<sup>374</sup>

In September 2008, HBMX’s internal audit group reviewed the Restoration Project and quickly identified multiple, growing problems. In an email describing the audit findings, Graham Thomson, head of the Latin American internal audit group, wrote:

“The key issues ... include slow progress with remediating PEPs/SCCs and other high risk customers, with some 40% of the KYC records of PEPs/SCC customer segment ... not yet remediated. These accounts are now in the process of closure by HBMX Legal. ... [C]hecks done by CMP [Compliance] on visit reports ... continue to reveal an unacceptable level of ‘manufactured’ visit reports.”<sup>375</sup>

Mr. Alonso, head of HSBC Latin America responded that the audit results were “disappointing” and “not what I was assured by HMBX management.”<sup>376</sup>

The audit report found that the Restoration Project had “major weaknesses ... that could potentially hinder regulatory compliance and the achievement of the project’s overall goals.”<sup>377</sup> It said that resources dedicated to the project “appeared insufficient to deliver the quality and timeliness required,” and clients engaged in high risk businesses “had not been identified for inclusion” in the project.<sup>378</sup> It noted that visit reports were incomplete and, in some cases, “created without visits being made.”<sup>379</sup> The audit report also stated:

“The impact of account cancellation on the business, customers and costs should be analysed against the risks that have been mitigated and accepted, as this will allow having adequate balance between control and business, particularly where cancellations may be attributable to internal errors rather than to the customers.”<sup>380</sup>

<sup>373</sup> Id.

<sup>374</sup> Id.

<sup>375</sup> 10/28/2008 email from HBMX Graham Thomson to HBMX Emilson Alonso, Luis Pena, John Rendall, and others, “HBMX – Proyecto Restauracion,” HSBC OCC 8873463-465.

<sup>376</sup> Id.

<sup>377</sup> Nov. 2008 “Branch Audit Report: HBMX Special Review of Restoration Project,” prepared by HBMX Group Internal Audit, HSBC OCC 8876417-424, at the Audit Report Summary Schedule, HSBC OCC 8876424.

<sup>378</sup> Id.

<sup>379</sup> Id.

<sup>380</sup> Id. at HSBC OCC 8876419.

This recommendation appears to suggest that some high risk accounts not be closed, even where the bank was unable to review the account by the regulatory deadline and KYC deficiencies might exist. Mr. Thomson's email indicated, however, that unremediated files for PEP and SCC clients subject to the Restoration Project were already in the process of being closed.<sup>381</sup> In addition, Mr. Rendall reported to the Latin American regional audit committee that "7,941 KYC files for high risk customers had been reviewed & updated, or scheduled for closure."<sup>382</sup> Mr. Rendall also reported that in the second phase of the project, "47,000 accounts with various risk flags" were being reviewed, with plans for a third phase to examine "83,000 accounts with historic CAMP alert profiles." These figures were well below, however, the 1.8 million in high risk accounts that were supposed to be reviewed to ensure KYC documentation met CNBV requirements.

**November Meeting with CNBV.** On November 26, 2008, a high level meeting took place between HSBC and CNBV. Michael Geoghegan, HSBC Group CEO, traveled to Mexico to attend. Along with Emilson Alonso, head of HSBC Latin America, and Luis Pena, head of HSBC Mexico, Mr. Geoghegan met with the President of CNBV, Guillermo Babt; the head of CNBV bank supervision, Patricio Bustamante; and the head of CNBV AML oversight, Pablo Gomez.<sup>383</sup> The focus of the meeting was expected to be the actions taken by HBMX to address the CNBV concerns identified in February 2008.

According to an email prepared by the Deputy Head of HSBC Group Compliance, Warren Leaming, who had accompanied Mr. Geoghegan to Mexico and remained there for several days,<sup>384</sup> the CNBV officials acknowledged the "significant progress" made by the bank, but remained "very concern[ed]" about the U.S. dollar accounts at HBMX's Cayman branch, the slow KYC review of those accounts, and the "sheer volume of US Dollars that HBMX repatriates" to the United States.<sup>385</sup> The email noted that, between January and September 2008, HBMX had repatriated \$3 billion to the United States, which represented 36% of the market and double what the biggest bank in Mexico, Banamax, had repatriated, even though HBMX was only the fifth largest bank in the country.<sup>386</sup> According to the email, CNBV officials were also

<sup>381</sup> 10/28/2008 email from HBMX Graham Thomson to HBMX Emilson Alonso, Luis Pena, John Rendall, and others, "HBMX – Proyecto Restauracion," HSBC OCC 8873464-465.

<sup>382</sup> 6/7/2010 email from HSBC Paul Lawrence to HSBC Michael Geoghegan, "Mexico Banknotes/High-level Timeline," HSBC-PSI-PROD-0198514-516.

<sup>383</sup> See 11/27/2008 email from HSBC Warren Leaming to HSBC David Bagley and Richard Bennett, "Mexico," HSBC OCC 8875605-607.

<sup>384</sup> See 12/8/2008 email from HSBC Warren Leaming to HBMX Ramon Garcia and John Rendall, "Mexico Visit," HSBC-PSI-PROD-0197874 (indicating Mr. Leaming visited HBMX from Nov. 25 to Nov. 28).

<sup>385</sup> 11/27/2008 email from HSBC Warren Leaming to HSBC David Bagley and Richard Bennett, "Mexico," HSBC OCC 8875606.

<sup>386</sup> Id.

“concerned that when-ever there is a serious MLD [Money Laundering Deterrence] scheme HSBC seems to be involved” and that “USA authorities are concerned at the very high levels.”<sup>387</sup> Mr. Geoghegan told the Subcommittee that his meeting with the Mexican regulators did not go as he had expected, he told the CNBV that HBMX would address the issues raised, and he immediately took action to ensure that happened.<sup>388</sup>

**Stopping U.S. Dollar Services.** After the meeting, Mr. Alonso sent an email to Mr. Pena asking him to examine the “export of cash USD to the USA,” including the volumes of U.S. dollars being exported, the types of clientele using the HBMX branch network to make U.S. dollar deposits for remittance to the United States, and the branches involved in more frequent deposits or higher volumes.<sup>389</sup> He also called for the “[i]mmediate elimination of this kind of service in our branches. Corporate clients that require such service should be approved by you on a very exceptional basis.”<sup>390</sup>

Later that same night, Mr. Geoghegan sent an email to Mr. Alonso stating: “It occurs to me: We should stop any Dollar remittances or accept any Dollar payments unless they are done via a customer’s account. We should stop shipping Dollars.”<sup>391</sup> He also wrote: “We should bench mark HBMX CAMP and other search engine systems with HBUS (they have some very sensitive behavior monitors) and see whether we are finding as many suspicious transactions as we should be.” Mr. Alonso forwarded the email to Mr. Pena, who responded the next day:

“The two immediate actions we are taking are:

Starting December 1. We will no longer buy or sell dollars in cash at ANY branch (customers or non customers). We will, as an alternative, offer travelers cheques to customers only. Also customers can withdraw dollars at HSBC ATMs located at airports or from any ATM in the world with their debit card.

Starting January 1. We will no longer accept deposits of cash dollars to any dollar account at any branch.

<sup>387</sup> Id.

<sup>388</sup> Subcommittee interview of Michael Geoghegan (5/24/2012).

<sup>389</sup> 11/26/2008 email from HBMX Emilson Alonso to HBMX Luis Pena, with copies to HSBC Michael Geoghegan and others, “Visit to CNBV – Findings and Required Actions,” HSBC OCC 8874846-847.

<sup>390</sup> Id.

<sup>391</sup> 11/26/2008 email from HSBC Michael Geoghegan to HBMX Emilson Alonso, “Money Laundering,” HSBC OCC 8874849-850. Mr. Geoghegan told the Subcommittee that he made a unilateral decision to stop these U.S. dollar services. Subcommittee interview of Michael Geoghegan (5/24/2012).

We are quantifying the impact of lost revenues. On the flipside, we will save the operating cost of transporting and exporting dollar bills.

This should take care of the problem.”<sup>392</sup>

Mr. Pena also proposed continuing indefinitely the freeze on opening new U.S. dollar accounts through HBMX’s Cayman branch, and prohibiting the acceptance of new cash deposits for the existing Cayman accounts.<sup>393</sup> HSBC Group Compliance Deputy Head Warren Leaming noted in an email to his supervisor, David Bagley, that when Mr. Pena commented that the actions being taken “could result in lost profits of many billions Mike[’]s clear response [was] that nothing is worth risk to our reputation.”<sup>394</sup> Mr. Leaming also wrote that the proposed actions were “considered extremely sensitive here in Mexico and local management want to get their ducks in a row ... so it will be much appreciated if the above could not be ... disseminated without discussing further.”

**Account Closing Backlog.** Mr. Leaming also noted that “there appears to be a huge back-log in closing accounts,” with customers continuing to use accounts in November that had been ordered closed eight months earlier in March. He wrote that those accounts, which were still being used by customers, may be “part of the reasons for multiple SARs” being filed for some accounts, potentially putting HBMX in breach of HSBC policy on account closure after multiple SARs.<sup>395</sup>

Mr. Bagley responded: “What I find most frustrating is the way in which new issues constantly emerge however much time is spent with HBMX.”<sup>396</sup> He continued: “The practice of changing USD in the branches pres[u]mably with little or no ID for non customers is in breach of Group policy. When looking at our USD exposure how can this have been missed.” He also asked Mr. Leaming to consider challenging the involvement of the Legal Department in the account closing process so that it could proceed more quickly.

The next day, November 28, 2008, Mr. Geoghegan sent an email to top HBMX and HSBC Group Compliance officials stating that it should be made clear to all HBMX personnel “that if there are persistent

<sup>392</sup> 11/27/2008 email from HBMX Luis Pena to HBMX Emilson Alonso, copy to HSBC Michael Geoghegan, “Money Laundering,” HSBC OCC 8874849.

<sup>393</sup> 11/27/2008 email from HSBC Warren Leaming to HSBC David Bagley and Richard Bennett, “Mexico,” HSBC OCC 8875605-607.

<sup>394</sup> Id.

<sup>395</sup> Id.

<sup>396</sup> 11/27/email from HSBC David Bagley to HSBC Warren Leaming and Richard Bennett, “Mexico,” HSBC OCC 8875605.

breaches of KYC in a particular branch, the branch will be closed and all staff dismissed regardless of how much business we will lose on account of it.”<sup>397</sup> He also required HBMX’s compensation scorecard to include implementing the CAMP monitoring system to the maximum extent possible and closing accounts with two or more SARs. He wrote: “[I]f you demonstrate zero tolerance of lapses in implementing KYC then the operations standards of the whole business improves at the same time. What we are doing in Mexico needs to be copied everywhere else in the region.”<sup>398</sup>

**AML Shock Plan.** Mr. Pena responded that in January 2009, he was planning to close two branches and fire all staff “as exemplary measures” and was working to identify the branches.<sup>399</sup> This measure was later referred to as the “AML Shock Plan.”<sup>400</sup> Mr. Pena also wrote:

“Last but not least, I will address the issue of funding. After all, Cayman and Mexican dollar accounts provide us with US\$2.6 billion of cheap funding. We are likely to lose a big portion of this if we tell customers we no longer receive dollar notes. We have to provide an alternative to our customers for this: Miami accounts may be an alternative but we will have to talk to HBUS of how we get this cheap funding back to Mexico to lend.”<sup>401</sup>

In December 2008, at the conclusion of his latest visit to Mexico, Mr. Leaming drafted a letter to Mr. Pena summarizing a number of AML issues and sought input from other HBMX officials before finalizing it.<sup>402</sup> His draft letter discussed the late filing of SARs, the backlog in closing accounts, the failure to close accounts after two SAR filings, slow and weak decisions by the CCC Committee, the need to clarify transaction limits, and the need for further refinement of the CAMP alert system. He noted that the account closing backlog consisted of over 3,600 accounts, of which 675 involved suspicion of money laundering and had been ordered closed by the CNBV, yet were still open. He also noted that 16 of the accounts remaining open had been ordered closed in 2005, 130 in 2006, 172 in 2007, and 309 in 2008. He wrote that he’d been advised that the law did not permit the accounts to be blocked pending closure, which meant account activity was

<sup>397</sup> 11/28/2008 email from HSBC Michael Geoghegan to HBMX Emilson Alonso with copies to HSBC David Bagley, HBMX Luis Pena, and others, “Final draft for Mike’s Letter,” HSBC OCC 8874857.

<sup>398</sup> Id.

<sup>399</sup> 11/28/2008 email from HBMX Luis Pena to HBMX Emilson Alonso, who forwarded it to HSBC Michael Geoghegan, David Bagley, and Matthew King, “Final draft for Mike’s Letter,” HSBC OCC 8874856.

<sup>400</sup> 12/8/2008 email from HSBC Warren Leaming to HBMX Ramon Garcia and John Rendall with copies to HSBC David Bagley, John Root, Susan Wright, and others, “Mexico Visit,” HSBC-PSI-PROD-0197874-876.

<sup>401</sup> Id.

<sup>402</sup> Id.



continuing. To speed up closures, he advised that his research had indicated the Legal Department did not have to participate and clients could be notified of the account closing by certified mail. Mr. Leaming also noted that 3,000 Cayman accounts had been proposed for closure which would further stress the process. In addition, he warned that the switch from U.S. dollar deposits to travelers cheques could also raise AML concerns, advised lowering the \$25,000 ceiling on the amount of travelers cheques that could be purchased by a customer, and creating a new limit on the amount of travelers cheques that could be deposited at one time to a client account. He recommended setting dollar limits on cashiers cheques as well.

Later in December, HBMX prepared to implement the new AML policies and procedures and close suspicious accounts.<sup>403</sup> December 22 and 24 were set as the dates to close four HBMX branches “as disciplinary actions,” with another 10 to 20 branches that, in January, would have all staff dismissed.<sup>404</sup> January 1, 2009 was set as the date to stop buying or selling U.S. dollars at HBMX branches.<sup>405</sup> It was also the date set for closing all accounts opened by casas de cambio. January 31 was set as the date to complete the Restoration Project and begin closing accounts that had incomplete documentation or were subject to at least two SAR filings.<sup>406</sup>

On December 22, 2008, an HBMX employee alerted the HBUS regional head of Banknotes, Gyanen Kumar to the HBMX’s plan to stop buying and selling U.S. dollars in the new year.<sup>407</sup> Mr. Kumar forwarded it to the Banknotes head Christopher Lok with the comment: “I have not been told anything firm as to why this decision is being taken as much as it is a drastic change. My instincts tell me that perhaps this has something to do with compliance.”<sup>408</sup> HBMX apparently did not explain, leaving HBUS uninformed about the compliance and regulatory pressures and AML risks behind HBMX’s decision to end its U.S. dollar business.

<sup>403</sup> See 12/15/2008 email exchange among HBMX Ramon Garcia and HSBC Warren Leaming, Susan Wright, John Root, David Bagley, and others, “Anti Money Laundering: Shock plan – Update 081215,” HSBC OCC 8875786-790; 12/23/2008 email from HSBC Warren Leaming to HBMX Catherine Bussery, with copies to HSBC David Bagley, John Root, and Richard Bennet, “Anti Money Laundering: Shock plan – Update 081215,” HSBC OCC 8873474-476; 1/27/2009 email from HSBC David Bagley to HSBC Susant Wright, with a copy to Warren Leaming, “Press Release,” HSBC OCC 8873485.

<sup>404</sup> 12/15/2008 email exchanges among Ramon Garcia to HSBC Warren Leaming, Susan Wright, John Root, David Bagley, and others, “Anti Money Laundering: Shock plan – Update 081215,” at HSBC OCC 8875786-787.

<sup>405</sup> Id.

<sup>406</sup> Id. Mr. Leaming expressed skepticism that the proposed closures could be completed by the January 31 deadline. Id.

<sup>407</sup> See 12/22/2008 email from HBMX Mario Langerica to HBUS Gyanen Kumar and others, “USD cash in Mexico,” HSBC-PSI-PROD-0095869-870.

<sup>408</sup> 12/23/2008 email from HBUS Gyanen Kumar to HBUS Denis O’Brien and Christopher Lok, “USD cash in Mexico,” HSBC-PSI-PROD-0095869.

**Law Enforcement and Regulators Converge.** In January 2009, HBMX began implementing the planned AML changes. It stopped buying and selling U.S. dollars and began closing accounts held by casas de cambio.<sup>409</sup>

That same month, U.S. regulators began contacting HBUS to get clarification about HBMX's decision to stop buying and selling U.S. dollars.<sup>410</sup> When asked, HBMX told HBUS the decision had been based primarily on cost considerations, without mentioning the compliance and AML concerns that led to the decision.<sup>411</sup> The regional head of HBUS' Banknotes department, Gyanen Kumar, who was traveling to Mexico the next week, was asked by his colleagues to get more information.<sup>412</sup> On January 13, HBMX sent HBUS a copy of its internal press release describing its decision.<sup>413</sup> Based upon HBMX's actions, HBUS decided to close banknotes accounts used by two Mexican clients, but to retain accounts with the same clients in the Payments and Cash Management (PCM) division.<sup>414</sup> Closing the banknotes accounts meant that the Mexican clients could no longer make bulk cash sales of their U.S. dollars to HBUS, but the continued operation of their PCM accounts meant that both Mexican clients could still deposit U.S. dollars, execute U.S. dollar transactions, exchange U.S. dollars for Mexican pesos, and access the U.S. wire transfer system.

Around the same time, the Immigration and Customs Enforcement (ICE) arm of the U.S. Department of Homeland Security (DHS) held a meeting with HBUS in New York, and informed it that ICE was conducting an investigation of a particular Mexican casa de cambio that had accounts at both HBUS and HBMX.<sup>415</sup> HBUS apparently did not relay that information to HBMX.

Five months later, in May 2009, HSBC Group increased its risk assessment for its Latin American operations to its highest risk rating.<sup>416</sup>

<sup>409</sup> An email suggests, however, that HBMX had decided to continue to offer U.S. banknotes products to several large reputable Mexican banks, Banamex, Banorte and Ixe, in effect making its first exceptions to the new policy. See 12/22/2008 email from HBMX Mario Langarica to HBUS Gyanen Kumar and others, "USD cash in Mexico," HSBC-PSI-PROD-0095869-870.

<sup>410</sup> See January 2008 email exchanges among HBUS Christopher Davies, Christopher Lok, Michael Gallagher, Paul Lawrence, Gyanen Kumar, and others, "HBMX Banknotes business," HSBC OCC 3633806-812.

<sup>411</sup> Id. at 810.

<sup>412</sup> Id. at 811.

<sup>413</sup> Id. at 809.

<sup>414</sup> Id. at 811, 807.

<sup>415</sup> Id. at HSBC OCC 3633806. HSBC Group Compliance head David Bagley remarked near the end of January: "An obvious learning point for HBMX is that if they were contacted by US authorities then they should have thought to advise HBUS. They can go round the web, not just through the middle of the web. 1/30/2009 email from HSBC David Bagley to HSBC Susan Wright, "US issues - Various," HSBC OCC 8873759.

<sup>416</sup> See 6/9/2009 email from HSBC David Bagley to HBMX Emilson Alonso, copies to HSBC Michael Geoghegan and others, "GMO Business reviews - LATAM," HSBC OCC 8874895.

When Emilson Alonso, HSBC Latin America head, protested, HSBC Group Compliance head David Bagley explained:

“I fully acknowledge the level of priority and focus that you and the team have given to these issues and the progress that has been made particularly in Mexico and have taken all of this into account. ...

The basis for the rating is however:

The inherent AML risk in Mexico is still very high and [t]here are not many other parts of the Group that have what is effectively a drugs war being conducted on the streets and also have the risk posed by potential sting and other operations by the US authorities. We have of course remediated our high risk accounts, but the historic weak account opening processes mean that we have overall lower levels of KYC across the customer base as a whole.”<sup>417</sup>

On May 1, 2009, HBUS suddenly reclassified Mexico from its lowest to its highest risk rating. HBMX personnel in Mexico protested, but HBUS did not change its rating. One consequence was that its Mexican clients were automatically deemed to be located in a high risk country, triggering enhanced scrutiny.

Later in June 2009, ICE contacted HBMX about its investigation into a particular Mexican casa de cambio that had an account at the bank.<sup>418</sup> A few days later, ICE contacted HBUS’ primary U.S. regulator, the OCC, and alerted the OCC to its investigation.<sup>419</sup> As a result, the OCC began intensifying its regulatory scrutiny of HBUS, in particular with respect to its U.S. banknotes business, which U.S. regulators later said had increased as HBMX’s decreased.<sup>420</sup>

At the same time, AML deficiencies continued to surface at HBMX. For example, in June 2010, HBMX noted that “certain transaction types were not being captured” by its AML account monitoring system, CAMP, and “therefore were not being monitored.”<sup>421</sup> HBMX also noted that the CAMP software had not been

<sup>417</sup> Id.

<sup>418</sup> See 6/28-29/2009 summary of telephone conversations, prepared by OCC Joseph Boss, OCC-PSI-00928759-761.

<sup>419</sup> Id.

<sup>420</sup> Paul Thurston told the Subcommittee that, in retrospect, while HBMX’s banknotes business appeared to be declining, HBUS’ banknotes business with Mexico had been increasing at the same time, due to its banknotes business with HBMX and former clients of HBMX. Subcommittee interview of Paul Thurston (5/1/2012).

<sup>421</sup> See 6/18/2010 email from HBUS Michael Anderson to HBMX Ken Harvey, with a copy to Andrew Zissell, “RMM action point,” HSBC OCC 8875492-493 (attaching Compliance Report on Mexico, numbered 53.2.1).

updated “since its installation in 2005.” In September 2010, the OCC issued a Supervisory Letter detailing massive AML deficiencies at HBUS, derived in part from its dealings with Mexico. The OCC followed with a Cease and Desist Order in October.

**Eight Years of HBMX AML Deficiencies.** HBMX and HSBC Group internal documents demonstrate that HBMX’s AML deficiencies were longstanding and widespread. Audit after audit detailed long lists of problems, including inadequate compliance resources, missing KYC information, manufactured site visits, inadequate account monitoring, unread alerts, poor training on the monitoring system and assigning SCC designations, internal disputes over closing accounts with suspicious activity, accounts left open despite multiple SARs and orders to close them, a SAR filing backlog, and an account closure backlog that spanned three years. AML leadership at HBMX was also weak. One AML director was dismissed for manufacturing notes of AML committee meetings that never took place; another was dismissed for inadequate performance; several long periods went by without any AML director in place at all. Even AML projects with resources and high level backing were unsuccessful, such as the Restoration Project which reported in 2008, that 75% of high risk client files still had inadequate KYC documentation.

The evidence obtained by the Subcommittee shows that HSBC Group was fully aware of the years-long, substantial AML and compliance problems at HBMX, originating with the bank’s purchase in 2002. The evidence also indicates that HSBC Group executives and compliance personnel worked to build a compliance culture, but repeatedly faced a workforce in Mexico that disregarded the Group’s AML policies and procedures, delayed obtaining required KYC data, delayed closing suspect accounts, and delayed reporting suspicious activity to regulators. In 2009, under pressure from regulators, HSBC Group took drastic measures, including prohibiting HBMX branches from buying or selling U.S. dollars, shuttering entire branches with checkered histories, and scheduling for closure thousands of accounts with incomplete KYC documentation. Even with those actions, HSBC Group acknowledged internally that HBMX continued to pose a high risk of money laundering to the Group.<sup>422</sup>

The evidence also indicates that while HSBC Group was fully informed about HBMX’s AML and compliance deficiencies, little of that information was conveyed to HBUS, despite HBMX’s extensive correspondent relationship with HBUS. When asked about the lack of communication, HBMX CEO Paul Thurston indicated that he reported

<sup>422</sup> See, e.g., 6/9/2009 email from HSBC David Bagley to HBMX Emilson Alonso, with copies to HSBC Michael Geoghegan and others, “GMO Business reviews – LATAM,” HSBC OCC 8874895.

HBMX's AML problems to HSBC Group and believed Group would communicate necessary information to HBUS.<sup>423</sup> HSBC Group CEO Michael Geoghegan told the Subcommittee that HBMX problems were discussed at HSBC Group Management Business (GMB) meetings, which HNAH CEO Brendan McDonagh attended, so he thought HBUS was aware of the problems.<sup>424</sup> HSBC Group Compliance head David Bagley told the Subcommittee that Group Compliance could have informed HBUS Compliance about the problems at HBMX, but "we did not think of it."<sup>425</sup> Instead, he reported the information to HSBC Group's senior management. Several senior HBUS executives told the Subcommittee that the bank was not informed of the extent of AML problems at HBMX. The result was, at the same time HBUS was handling hundreds of billions of dollars in cash transactions for HBMX, processing U.S. dollar wire transfers, clearing U.S. dollar travelers cheques, and opening U.S. dollar accounts for HBMX clients, HBUS was left in the dark by its own colleagues about the extensive AML and compliance problems at HBMX. In addition, in conformance with HSBC Group policy and practice, HBUS conducted no due diligence assessment of HBMX, did not evaluate its riskiness, did not review its audit findings, and did not monitor its wire transfers, cash letter activity, or banknotes transactions for suspicious activity. HBUS had rendered itself blind to the fact that it was servicing a high risk financial institution.

#### **D. HBMX High Risk Clients**

HBMX made extensive use of its correspondent relationship with HBUS. From its acquisition in 2002, HMBX worked with HBUS's Payments and Cash Management (PCM) division and, until 2010, with HBUS' Global Banknotes division, both headquartered in New York. HBMX used its correspondent and banknotes accounts to process U.S. dollar wire transfers, clear U.S. dollar monetary instruments like travelers cheques, and deposit bulk cash shipments of U.S. dollars on behalf of itself and its clients. Three examples of HBMX high risk clients help illustrate how HBMX's AML deficiencies also created risk for HBUS. They include high risk Mexican and U.S. money service businesses, clients using offshore U.S. dollar accounts in the Cayman Islands, and purchasers of millions of dollars in U.S. dollar travelers cheques.

##### **(1) High Risk Money Service Businesses**

Mexican casas de cambio (CDCs) are money service businesses licensed by the Mexican Treasury Department (SHCP), through the

<sup>423</sup> Subcommittee interview of Paul Thurston (5/1/2012).

<sup>424</sup> Subcommittee interview of Michael Geoghegan (5/24/2012).

<sup>425</sup> Subcommittee interview of David Bagley (5/10/2012).

CNBV, to exchange foreign currencies for a fee. In Mexico, CDCs are not licensed as banks and do not hold deposits, maintain checking or savings accounts, or provide other banking services.<sup>426</sup> Instead, CDCs are typically limited to accepting currency from a customer, exchanging it for another currency, and then either handing it over to the customer or wiring it to a financial institution in another country, such as the United States.<sup>427</sup>

In the United States, some money service businesses perform similar cross-border services, enabling individuals in the United States to wire U.S. dollars to Mexico, where the dollars may be converted into Mexican pesos and paid out to a designated recipient. Those U.S. money service businesses are sometimes referred to as money remitters. Both Mexican CDCs and U.S. money service businesses often perform their services for walk-in customers, although they may also have established customers who use their services on a regular basis. In both Mexico<sup>428</sup> and the United States,<sup>429</sup> CDCs and money service businesses are legally required to establish AML programs to safeguard against laundering criminal proceeds.

#### (a) Casa de Cambio Puebla

Until 2007, Casa de Cambio Puebla (Puebla) was a licensed casa de cambio, founded in 1985, with branch offices throughout Mexico.<sup>430</sup> On May 16, 2007, the United States obtained a warrant from a Federal court in Florida and froze or seized all Puebla funds on deposit with Wachovia Bank in Miami, as well as with Wachovia Bank in London, affecting funds totaling over \$11 million.<sup>431</sup> In July 2007, Puebla filed a civil complaint seeking the release of those funds.<sup>432</sup> In 2008, the United States indicted Puebla, two of its officers,<sup>433</sup> and two other individuals on drug smuggling and money laundering charges.<sup>434</sup> In 2009, one of the defendants was arrested and, in 2010, pled guilty to conspiracy to launder money,<sup>435</sup> and was sentenced to 14 months in prison, while the other defendants, including Puebla, were placed on

<sup>426</sup> See *United States v. Wachovia Bank N.A.*, Case No. 10-20165-CR-Lenard (USDC SDFL), Factual Statement, Exhibit A to Deferred Prosecution Agreement (3/16/2010), at ¶ 12.

<sup>427</sup> *Id.*, at ¶ 11.

<sup>428</sup> See Article 95 *bis* of the General Law of Auxiliary Credit Organizations.

<sup>429</sup> See 31 USC § 5318(h)(1) and § 5312(J) and (R).

<sup>430</sup> *Casa de Cambio Puebla, S.A. v. United States*, Case No. 10-20165 (USDC SDFL), Petition for Return of Seized Funds (7/12/2007)(hereinafter "Puebla Petition"), at 4.

<sup>431</sup> Puebla Petition, at 2-3.

<sup>432</sup> *Id.*

<sup>433</sup> See *id.*, at 19.

<sup>434</sup> See *United States v. Casa de Cambio Puebla, S.A., Jose A. Gutierrez de Velasco Hoyos, Amador Cordero Vasquez, Pedro Alfonso Alatorre Damy, a/k/a "Pedro Barraza Uruguastegui," and Leonardo Vasquez Estrada*, Case No. 08-20097-CR-Graham (USDC SDFL), Indictment (2/1/2008, unsealed 11/4/2009).

<sup>435</sup> *Id.*, Plea Agreement (7/9/2010), at ¶ 1.

fugitive status.<sup>436</sup> In addition, in 2010, Wachovia Bank entered into a deferred prosecution agreement with the U.S. Department of Justice for having failed to maintain an effective anti-money laundering program<sup>437</sup> in connection with its casa de cambio business, including with respect to Puebla.<sup>438</sup> Those legal proceedings, which involved a major Mexican CDC and major U.S. bank, received widespread attention.<sup>439</sup>

Puebla was a longtime customer of HBMX, having first begun a relationship with HBMX's predecessor, Bital, in the 1980s.<sup>440</sup> In 2004, Puebla also opened a U.S. banknotes account with HBUS.<sup>441</sup> By 2007, Puebla had several accounts at HBMX, as well as an outstanding loan.<sup>442</sup> After the United States seized the company's funds at Wachovia Bank in May 2007, HBUS suspended the Puebla account two weeks later and closed the account in June 2007.<sup>443</sup> HBMX did not actually close the account until November 2007, and then only after the Mexican Attorney General served an order on the bank seizing Puebla funds.

**Puebla at HBMX.** At the time of the May 2007 seizure of more than \$11 million in Puebla funds at Wachovia Bank, HBMX was already reeling from another money laundering scandal involving a March 2007 seizure of cash, weapons, and wire transfer records from the Mexican residence of longtime customer, Zhenly Ye Gon and his pharmaceutical companies, Unimed Pharm Chem, Constructora e Inmobiliaria Federal, and Unimed Pharmaceutical.<sup>444</sup> That seizure had triggered an intensive review by senior HBMX officials of the Ye Gon-related accounts as well as HBMX's overall AML program. The Puebla case added another high

<sup>436</sup> See id., docket entries 12, 34, 38-42.

<sup>437</sup> United States v. Wachovia Bank N.A., Case No. 10-20165-CR-Lenard (USDC SDFL), Deferred Prosecution Agreement (3/16/2010), at ¶ 3.

<sup>438</sup> Id., Factual Statement, Exhibit A to Deferred Prosecution Agreement (3/16/2010), at ¶ 11.

<sup>439</sup> See, e.g., "U.S. freezes Mexico exchange bureau accounts for money laundering," EFE News Services Inc. (6/9/2007); see also "Wachovia is Under Scrutiny in Latin Drug-Money Probe," Wall Street Journal, Evan Perez and Glenn R. Simpson, April 26, 2008. In addition, the U.S. State Department discussed the Puebla case in its 2009 International Narcotics Control Strategy Report. See 2009 International Narcotics Control Strategy Report, U.S. Department of State, at 356-357.

<sup>440</sup> See, e.g., July 2007 email exchanges among HBMX Paul Thurston, John Rendall, Ramon Garcia, and others, "[subject redacted by HSBC], HSBC OCC 8875132-135.

<sup>441</sup> See 6/5/2007 email from HBUS Daniel Jack to HBMX Leopoldo Barroso, "HSBC in Mexico -- AML Compliance & Casa de Cambio," HSBC-PSI-PROD-0095913.

<sup>442</sup> See 5/1/2008 memorandum [carrying incorrect date of 5/1/2007] from HBUS Judy Stoldt and Gloria Stazza to HBUS Denise Reilly, "Wall Street Journal Article Regarding Wachovia," OCC-PSI-01358515.

<sup>443</sup> See 12/20/2007 HBUS Compliance Certificate, OCC-PSI-00227523, at 5.

<sup>444</sup> See In re Zhenly Ye Gon, Case No. 1:07-cr-00181-EGS (USDC DC), Complaint for Arrest with a View Towards Extradition (9/15/2008) (hereinafter "Ye Gon Extradition Complaint"), at 13; "Mexican Fugitive and Co-Conspirator Arrested on U.S. Drug, Money Laundering Charges," U.S. Drug Enforcement Administration press release (7/24/2007), <http://www.justice.gov/dea/pubs/states/newsrel/wdo072407.html>.

profile problem for HBMX, not least because Puebla also handled Ye Gon funds.<sup>445</sup>

In late May 2007, HBUS learned of the seizure of Puebla funds at Wachovia Bank, and quickly suspended activity in the Puebla correspondent account at HBUS.<sup>446</sup> It is not clear when HBMX first learned of the seizure, but by early June, both banks were considering whether to close their Puebla accounts. On June 5, 2007, Leopoldo Barroso, HBMX's AML head, received an email from a senior AML Compliance officer at HBUS, Daniel Jack, asking if Mr. Barroso was the new AML director at HBMX and "wonder[ing] what relationships" HBMX had with Puebla.<sup>447</sup> Mr. Barroso responded that HBMX had "a few DDAs [Demand Deposit Accounts] and a loan" with Puebla.<sup>448</sup> He also indicated that HBMX planned to "decide within the next 5 days" whether to terminate its relationship with Puebla, and asked Mr. Jack to let him know if HBUS decided to take that action.<sup>449</sup>

Mr. Jack noted in a later email that he did not tell Mr. Barroso during the June 5 email exchange about "the DEA seizure or Wachovia closing [Puebla] acc[oun]ts," although it is possible that HBMX already knew.<sup>450</sup> Mr. Jack also did not disclose that HBUS had already suspended Puebla's account activity a week earlier, on May 31, 2007.<sup>451</sup> Mr. Jack told the Subcommittee that, soon after the June 5 email exchange, he told Mr. Barroso that HBUS had shut down its account with Puebla.<sup>452</sup> When Mr. Barroso asked if HBUS could provide him with a list of their banknote customers in Mexico and the amount of U.S. dollars they exported from Mexico to the United States, Mr. Jack demurred, responding that there were "privacy issues" but that he would "see what info" he could share.<sup>453</sup> This exchange between senior AML

<sup>445</sup> See 10/13/2007 "Reportan ruta de Ye Gon para 'blanquear' dinero" ("Ye Gon reported path to 'launder' money"), *El Universal*, Francisco Gómez, [www.eluniversal.com.mx](http://www.eluniversal.com.mx) (reporting that the Mexican agency SHCP had determined that, from 2003 to 2006, Mr. Ye Gon and his companies had moved \$90 million through four major Mexican banks and multiple casas de cambio, including HBMX and Puebla), cited in 7/18/2008 Report of Findings (Update) for Consultoria Internacional Banco, prepared by HBUS Financial Intelligence Unit, OCC-PSI-00247712.

<sup>446</sup> See 5/31/2007 email from HBUS Alan Ketley to HBUS Gyanen Kumar and others, "With immediate effect we are suspending all activity with the subject client," HSBC PSI PROD 0095908-910; 6/6/2007 email from HBUS Daniel Jack to HBUS Alan Ketley, Re: HSBC in Mexico – AML Compliance and Casa de Cambio, HSBC-PSI-PROD-0095912.

<sup>447</sup> 6/5/2007 email from HBUS Daniel Jack to HBMX Leopoldo Barroso, "HSBC in Mexico – AML Compliance and Casa de Cambio," HSBC-PSI-PROD-0095914.

<sup>448</sup> 6/6/2007 email from HBUS Daniel Jack to HBUS Alan Ketley, Re: HSBC in Mexico – AML Compliance and Casa de Cambio, HSBC-PSI-PROD-0095912.

<sup>449</sup> Id.

<sup>450</sup> Id.

<sup>451</sup> See 5/31/2007 email from HBUS Daniel Jack to HBUS Alan Ketley, "N-NY & Casa de Cambio Puebla in Mexico," HSBC-PSI-PROD-0095908; 5/30/2007 email from HBUS Gyanen Kumar to "US Banknote Dept Sales Team," "Casa de Cambio Puebla," HSBC OCC 7688742.

<sup>452</sup> Subcommittee interview of Daniel Jack (3/13/2012).

<sup>453</sup> 6/6/2007 email from HBUS Daniel Jack to HBUS Alan Ketley, "HSBC in Mexico – AML Compliance and Casa de Cambio," HSBC-PSI-PROD-0095912.



Compliance personnel at HBUS and HBMX suggests that information sharing between the two banks was guarded, rather than automatic.

In early July 2007, HBMX Compliance head, Ramon Garcia, disclosed in an internal weekly report that went to HSBC Group Compliance that the HBMX CCC Committee had considered closing the Puebla account, but decided instead to retain the client. In response, John Root, a senior HSBC Group Compliance officer, sent him a blistering email criticizing the CCC Committee for “rubber-stamping unacceptable risks.” This email, cited earlier in a discussion of HBMX’s CCC Committee, is relevant again, because it applies to the Puebla account. Mr. Root wrote:

“It looks like the business is still retaining unacceptable risks and the AML committee is going along after some initial hemming and hawing. I am quite concerned that the committee is not functioning properly. Alarmed, even. I am close to picking up the phone to your CEO.”<sup>454</sup>

Mr. Root’s email went on to harshly criticize the CCC Committee’s decisions to keep open accounts for Mr. Ye Gon and another accountholder under suspicion for money laundering, before describing as “strike three,” the decision to retain the Puebla “relationship after USD11 million was seized by the authority in [Redacted by HSBC] account with Wachovia in Miami.” Mr. Root continued:

“What?! The business was okay with this? The AML Committee just can’t keep rubber-stamping unacceptable risks merely because someone on the business side writes a nice letter. It needs to take a firmer stand. It needs some cojones. We have seen this movie before, and it ends badly.”<sup>455</sup>

Mr. Garcia responded that he was escalating the decision on Puebla to the HSBC Mexico CEO, since the relevant HBMX business division had disagreed with a Compliance recommendation to close the account.<sup>456</sup> The next week, HSBC Mexico CEO Paul Thurston agreed with closing the account.<sup>457</sup> Mr. Rendall suggested alerting their U.S.

<sup>454</sup> 7/17/2007 email from HSBC John Root to HBMX Ramon Garcia, with copies to Susan Wright, David Bagley, and Warren Leaming, “Weekly Compliance Report 02JUL-06JUL07,” HSBC OCC 8875925-927.

<sup>455</sup> Id.

<sup>456</sup> See 7/18/2007 email from Ramon Garcia to HBC David Bagley, “Weekly Compliance Report 02JUL-06JUL07,” HSBC OCC 8875925.

<sup>457</sup> See July 2007 email exchanges among HBMX Paul Thurston, John Rendall, Ramon Garcia, and others, “[subject redacted by HSBC], HSBC OCC 8875132-135.

counterparts at HBUS, since HBUS also had a correspondent relationship with Puebla.<sup>458</sup>

Despite Mr. Thurston's July 2007 decision to close the Puebla account, HBMX did not actually close or freeze its Puebla account for another four months, allowing Puebla continued use of HBMX's correspondent account at HBUS.<sup>459</sup> HBMX finally closed the account in November 2007, after receiving a seizure warrant from the Mexican Attorney General seeking all funds in accounts opened in the name of Puebla or related parties.<sup>460</sup>

The seizure warrant named 91 parties related to Puebla, of which 81 were HBMX customers who presumably were also using the HBMX correspondent account at HBUS.<sup>461</sup> HBMX later determined that, from January 1 through October 31, 2007, a period of ten months, approximately 650 wire transactions had cleared through the "HBSC Mexico correspondent account" at HBUS, where Puebla was either the originator or the beneficiary.<sup>462</sup> Of those transactions, 170 wire transfers totaling \$7.3 million were conducted by six individuals or entities linked to Puebla.<sup>463</sup> All of those wires were later traced back to the Puebla accounts frozen at Wachovia.<sup>464</sup> The OCC later observed: "[T]hese discoveries about the level of CDC activity should have raised concerns for HBUS and alerted the bank to the need to obtain basic due diligence for HSBC Mexico and other Group Entities."<sup>465</sup>

**Puebla at HBUS.** While HBMX exposed HBUS to considerable money laundering risk through the transactions it conducted for Puebla,

<sup>458</sup> Id.

<sup>459</sup> See, e.g., 10/27/2007 Compliance Certificate, prepared by HBUS Compliance and provided to HSBC Group Compliance, HSBC PSI PROD 0095916-922, at 919 (listing major HBUS compliance issues, including "HBUS Ban[k]notes/Casa De Cambio Puebla (RED 3870): No transactions have been conducted with Casa de Cambio Puebla SA de CV in Mexico since 1JUN07. Although HBMX continues to deal with this Money Services Business, HBUS plans to formally terminate the Banknotes relationship soon.").

<sup>460</sup> See 12/11/2007 email from HBMX Leopoldo Barroso to HBUS Daniel Jack, "HSBC & Casa de Cambio Puebla in Mexico - Negative Press," HSBC OCC 7688750. The Attorney General identified 91 related parties.

<sup>461</sup> See 5/1/2008 memorandum [carrying incorrect date of 5/1/2007] from HBUS Judy Stoldt and Gloria Stazza to HBUS Denise Reilly, "Wall Street Journal Article Regarding Wachovia," OCC-PSI-01358515.

<sup>462</sup> Id.; 9/13/2010 OCC Supervisory Letter HSBC-2010-22, "Bank Secrecy Act/Anti-Money Laundering ('BSA-AML') Examination - Program Violation (12 U.S.C. §1818(s); 12 C.F.R. §21.21)," at 24. [Sealed Exhibit.]

<sup>463</sup> Id. See also 5/1/2008 memorandum [carrying incorrect date of 5/1/2007] from HBUS Judy Stoldt and Gloria Stazza to HBUS Denise Reilly, "Wall Street Journal Article Regarding Wachovia," OCC-PSI-01358515.

<sup>464</sup> 5/1/2008 memorandum [carrying incorrect date of 5/1/2007] from HBUS Judy Stoldt and Gloria Stazza to HBUS Denise Reilly, "Wall Street Journal Article Regarding Wachovia," OCC-PSI-01358515.

<sup>465</sup> 9/13/2010, Supervisory Letter HSBC-2010-22, OCC Sally Belshaw to HBUS Irene Dornier and David Bagley, Re: Bank Secrecy Act/Anti-Money Laundering ('BSA-AML') Examination - Program Violation (12 U.S.C. §1818(s); 12 C.F.R. §21.21)," at 25. [Sealed Exhibit.]

HBUS also incurred risk from its own direct dealings with Puebla, including a U.S. banknotes account it opened for Puebla in 2004. In just three years, Puebla substantially boosted its use of that U.S. banknotes account, swelling its sales of U.S. dollars to HBUS from \$18 million in February 2005, to \$113 million in March 2007, a tenfold increase.<sup>466</sup>

When AML monitoring alerts raised red flags about the growing flood of U.S. dollars from Puebla, HBUS bankers provided a number of explanations for the increases, none of which considered whether Puebla might be accepting illegal drug proceeds that drug cartels were then smuggling into Mexico from the United States. For example, when Puebla's U.S. dollar volumes increased by \$3 million between November 2005 and February 2006, an HBUS banker wrote that the "[c]lient is slowing [sic] growing its business volume as a result of better cash flow thanks to dealing with HSBC i.e., faster turnaround of banknotes."<sup>467</sup> When the volume jumped by another \$13 million the very next month, the HBUS banker offered the same explanation, typo and all: "[c]lient is slowing [sic] growing its business volume as a result of better cash flow thanks to dealing with HSBC i.e., faster turnaround of banknotes." This cut-and-paste explanation offers no evidence that the banker used due diligence to analyze the sudden multi-million-dollar increase. When the volume climbed again, by more than \$20 million from April 2006 to September 2006, to over \$76 million, the HBUS banker asked for an explanation wrote: "Mexico as a whole and more specifically [Puebla] is the premier country/msb [money service business] USD [U.S. dollar] remitter. There is [a] large population of Mexican[s] working in the U.S. during the summer months (landscaping) that send money back home (religiously) to their families."<sup>468</sup> While that might have been true, it was equally true when Puebla transmitted just \$27 million back to Mexico around the same time the previous year, a nearly \$50 million difference.<sup>469</sup> By the end of March 2007, the month before Puebla funds were seized at Wachovia Bank, its monthly U.S. dollar transactions at HBUS had exceeded \$113 million.<sup>470</sup>

On May 30, 2007, two weeks after the seizure of Puebla funds on May 16, HBUS ordered all activity in the Puebla account to be suspended with "immediate effect."<sup>471</sup> A week later, on June 5, 2007, HBUS AML Compliance officer Daniel Jack contacted HBMX to

<sup>466</sup> Spreadsheet: Banknotes – NY Selected Customers' Activity Alerts & Traders' Explanations for USD Purchases & Sales from 2005-2009, OCC-PSI-0005890-894.

<sup>467</sup> Id. at 892.

<sup>468</sup> Id. at 893.

<sup>469</sup> Id. at 892.

<sup>470</sup> Id. at 893.

<sup>471</sup> 5/31/2007 email from HBUS Gyanen Kumar to HBUS Alan Ketley and others, "Casa de Cambio Puebla," HSBC-PSI-PROD-0095910. See also 5/31/2007, email from HBUS Daniel Jack to HBUS Alan Ketley, "N-NY & Casa de Cambio Puebla in Mexico," HSBC-PSI-PROD-0095908.

ascertain whether Puebla also had accounts there, which would continue to expose HBUS to the money laundering risks associated with Puebla through the HBMX correspondent account.<sup>472</sup>

HBUS terminated its Banknotes relationship with Puebla after conducting a site visit on June 11, 2007.<sup>473</sup> In June and July 2007, HBUS was contacted by multiple U.S. law enforcement agencies regarding its correspondent accounts with financial institutions in Mexico, including Puebla. On June 25, 2007, for example, the Drug Enforcement Administration and other law enforcement told HBUS of their interest in its “banknote trading with” Puebla.<sup>474</sup> On July 17, 2007, HBUS met with “an analyst from the National Drug Intelligence Center of the US Dep[artmen]t of Justice to explain our business and AML program along with discussing cross-border issues.”<sup>475</sup> On July 20, 2007, HBUS met with FinCEN specialists “to discuss our wholesale banknotes business with clients in Mexico as well as our AML program, CTR filing and related issues.”<sup>476</sup> The extent to which HBUS informed HBMX about the level of U.S. law enforcement interest in Puebla is unclear.

#### (b) Sigue Corporation

Another HBMX client that used HBMX’s correspondent account at HBUS was Sigue Corporation (Sigue), a U.S. licensed money service business incorporated in Delaware but headquartered in California.<sup>477</sup> Sigue’s primary business activity was transmitting funds on behalf of third parties from the United States to Mexico and Latin America.<sup>478</sup> Acting through its operating company, Sigue LLC, it arranged for the remittance of U.S. dollars through a network of more than 7,500 “authorized delegates” or agents across the United States, most of which were small businesses under contract to offer Sigue’s money transmission services.<sup>479</sup>

On January 28, 2008, Sigue entered into a deferred prosecution agreement with the U.S. Department of Justice, Drug Enforcement Administration, and Internal Revenue Service, admitting that it had

<sup>472</sup> See 6/5/2007 email from HBUS Daniel Jack to HBMX Leopoldo Barroso, “HSBC in Mexico – AML Compliance and Casa de Cambio,” HSBC-PSI-PROD-0095914. See also 10/26/2007 memorandum from HBUS Carolyn Wind to HNAH Janet Burak and others, HSBC-PSI-PROD-0095919.

<sup>473</sup> See 12/20/2007 HBUS Compliance Certificate, OCC-PSI-00227523, at 5.

<sup>474</sup> *Id.*

<sup>475</sup> *Id.* at 2.

<sup>476</sup> *Id.*

<sup>477</sup> See *United States v. Sigue Corp. and Sigue LLC*, Case No. 4:08CR54 (USDC EDMO), Deferred Prosecution Agreement Factual Statement (1/28/2008), at 1.

<sup>478</sup> *Id.*

<sup>479</sup> *Id.*

failed to maintain an effective anti-money laundering program.<sup>480</sup> As part of the agreement, Sigue admitted to “serious and systemic” violations of U.S. AML requirements from 2003 to 2005, which “allowed tens of millions of dollars of suspicious financial transactions to be conducted through Sigue, including transactions involving funds represented by undercover U.S. law enforcement agents to be drug proceeds.”<sup>481</sup> The drug proceeds which U.S. undercover agents transmitted through Sigue totaled more than \$500,000, and were sent through 59 separate Sigue agents in 22 states.<sup>482</sup> The undercover federal agents had explicitly informed Sigue agents that they were transmitting illegal drug proceeds, structured the transactions to evade U.S. reporting obligations, and wired the funds to seven law enforcement agents in Mexico City, creating a money laundering pattern that Sigue should have detected and reported as suspicious activity, but did not.<sup>483</sup> Sigue admitted its failure to adequately supervise and control its agents, “effectively monitor and investigate high risk transactions,” “establish an effective risk-based AML program,” and “exercise sufficient enhanced due diligence for high-risk transactions and customers.”<sup>484</sup> As part of the agreement to defer prosecution of the company, Sigue agreed to forfeit \$15 million in suspect funds and spend \$9.7 million to strengthen its AML program.<sup>485</sup>

The day after the deferred prosecution agreement was made public in court, an article discussing Sigue’s misconduct and “record penalty” for a money service business concluded that a “case such as that against Sigue gives banks yet another reason to treat MSBs [money service businesses] as pariahs.”<sup>486</sup> David Bagley, HSBC Group Compliance head, sent a copy of the article to Susan Wright, head of AML Compliance for HSBC Group, with a handwritten note: “Obvious question – I assume they are not our customer.”<sup>487</sup> His assumption, however, was incorrect.

After learning that Sigue was, in fact, a client of HBMX, on February 1, 2008, Ms. Wright sent an email to HBMX Compliance head Ramon Garcia about the account.<sup>488</sup> She noted that, despite the deferred prosecution agreement and Sigue’s admission of wrongdoing, HBMX’s

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<sup>480</sup> Id.

<sup>481</sup> Id.

<sup>482</sup> Id.

<sup>483</sup> Id. at 1-3.

<sup>484</sup> Id. at 6.

<sup>485</sup> Id. at 12-15; Deferred Prosecution Agreement at ¶¶ 5, 9.

<sup>486</sup> “Money Laundering ‘Sting’ led to MSB’s Record Penalty, Says Legal Pact,” *Complinet*, Brett Wolf, (1/29/2008), reprinted at HSBC OCC 8875020.

<sup>487</sup> See handwritten note on copy of article, “Money Laundering ‘Sting’ led to MSB’s Record Penalty, Says Legal Pact,” *Complinet*, Brett Wolf, (1/29/2008), HSBC OCC 8875020.

<sup>488</sup> 2/1/2008 email from HSBC Susan Wright to HBMX Ramon Garcia, with copies to HSBC Warren Learning and John Root, no subject line, HSBC OCC 8875141.

commercial banking division wanted to retain the account. She warned that, if the account were retained, it:

“will need to be closely monitored and subject to frequent reviews (recommendation for quarterly reviews in current circumstances). The actions by the US regulators should be used as a trigger event and our due diligence on this client updated. In this connection the high risk profile that is in place for Financial Institutions should be used. ... If we only see batched transactions then we are relying on the screening undertaken by [Sigue]. It would be helpful to understand the nature of these transactions and currencies involved – could you provide me with an overview? We should also monitor the volume – you mentioned that we are not [Sigue’s] only bankers in Mexico. If, however, any of the other banks withdraw then we may well see the volume of transactions through us rise and our exposure/risk will increase with a corresponding increase in the cost of monitoring, etc.”<sup>489</sup>

Her email was forwarded to HSBC Compliance head David Bagley who, on February 4, 2008, forwarded it to HBMX CEO Paul Thurston and recommended closing the Sigue account.<sup>490</sup> Mr. Bagley noted Sigue’s “serious and systemic violations and a record fine” due in part to the fact that Sigue “had little control over its numerous agents.” He wrote: “Whilst the company will now need to take steps to address these deficiencies this will inevitably take some time, and instilling the appropriate culture within the business even longer.”

Mr. Thurston forwarded Mr. Bagley’s recommendation to John Rendall, HBMX COO, and asked for more information about the account.<sup>491</sup> Mr. Rendall reminded him that “a couple of months back,” HBMX Compliance had recommended closing the Sigue account, but was opposed by the HBMX commercial banking division (CMB) that wanted to keep the account open.<sup>492</sup> The issue was then elevated to Mr. Thurston who decided against closing the account.<sup>493</sup> Mr. Rendall explained:

“Our recommendation, which you supported, was to maintain this relationship. It was based on the following factors: A) our CMB team in Tijuana were relatively on the top of the case; B) the

<sup>489</sup> Id.

<sup>490</sup> 2/4/2008 email from HSBC David Bagley to HBMX Paul Thurston, [subject redacted by HSBC], HSBC OCC 8875020-021.

<sup>491</sup> See 2/4/2008 email from HBMX John Rendall to HBMX Paul Thurston, “[redacted by HSBC],” HSBC OCC 8875139.

<sup>492</sup> See 2/4/2008 emails from HBMX John Rendall and HBUS David Bagley, “[redacted by HSBC],” HSBC OCC 8875139-40.

<sup>493</sup> See 2/4/2008 email from HBMX John Rendall to HBMX Paul Thurston, “[redacted by HSBC],” HSBC OCC 8875139.

events for which [Sigue] have been fined were relatively historic – from memory, 2-3 years ago, and significant improvements had been made since then.”<sup>494</sup>

Despite Sigue’s admission of wrongdoing, its admission of lax controls over the actions taken by its agents, and the recommendation of the head of HSBC Group Compliance to close the account, Mr. Thurston decided once again to retain it and to continue to provide Sigue with U.S. dollar transactions through the HBMX accounts at HBUS.

Mr. Thurston told the Subcommittee that Sigue was one of the few accounts he decided to retain over the objection of HBMX Compliance. He explained that he did so, because he believed the issues were in the past, and Compliance head Ramon Garcia had met with Sigue and believed it was meeting its commitment to strengthen its AML program.<sup>495</sup>

Also on February 4, 2008, after reviewing an earlier media report identifying HBMX as a “pay partner” for Sigue,<sup>496</sup> the OCC AML Examiner then reviewing HBUS’ AML program “requested HSBC management to determine what, if any, involvement HSBC had with Sigue.”<sup>497</sup> The OCC inquiry triggered an inquiry into the Sigue account by HBUS, which had not been privy to the exchanges between HSBC Group and HBMX about the account.<sup>498</sup>

On February 5, 2008, HBUS informed the OCC AML Examiner that while Sigue was not an HBUS client, it was a client of HBMX and had executed U.S. dollar wire transfers through HBMX’s correspondent accounts at HBUS.<sup>499</sup> In an internal memorandum summarizing the information, the OCC AML Examiner wrote that HBUS “acts as a pass-through for wire transfers for Sigue.”<sup>500</sup> He noted that, for “the period of January through December 2007 159 wire transfers passed through HSBC originated by Sigue for the benefit of” HBMX, involving more

<sup>494</sup> See 1/2/2008 email from HBUS Susan Wright to HBMX Ramon Garcia, “[redacted by HSBC],” HSBC OCC 8875141.

<sup>495</sup> Subcommittee interview of Paul Thurston (5/1/2012).

<sup>496</sup> See “California MSB Faces Record Fine From Justice Department in AML Case,” *Fortent Inform*, Brian Monroe (1/11/2008); see also 2/5/2008 OCC memorandum to files, “HSBC Monitoring/Reputation Risk,” OCC-PSI-01416736 [sealed exhibit].

<sup>497</sup> 2/5/2008 OCC memorandum to files, “HSBC Monitoring/Reputation Risk,” OCC-PSI-01416736, at 2. [Sealed Exhibit.]

<sup>498</sup> The OCC Examiner noted internally at the time: “Although HSBC management was previously aware of media reports concerning Sigue, up to the time of our request, HSBC management had not conducted any enhanced due diligence and/or in-depth analysis to determine HSBC’s potential exposure resulting from the prosecution of Sigue.” *Id.* at 2 (emphasis in original omitted).

<sup>499</sup> See 2/5/2008 OCC memorandum to files, “HSBC Monitoring/Reputation Risk,” OCC-PSI-01416736, at 3. [Sealed Exhibit.]

<sup>500</sup> *Id.*

than \$485 million.<sup>501</sup> He wrote that HBUS management had agreed that those wires should have triggered a review of the account activity.<sup>502</sup>

The OCC AML examiner saw the events surrounding the Sigue account as emblematic of a broader problem involving inadequate monitoring and weak AML investigations by HBUS of clients using correspondent accounts to conduct suspect transactions. In the internal memorandum, the OCC AML examiner wrote:

“Over the past few years, there have been a number of instances where the OCC has brought to the attention of HSBC management negative media events, publicized indictments, etc., resulting in the need for HSBC management to conduct ad-hoc reviews to determine potential reputational risk. In the majority of these instances, HSBC management was either not aware of these events or had not been pro-active in determining the level of potential exposure due to these events.”<sup>503</sup>

He concluded that if he had “not intervened it is highly unlikely that HSBC management would have performed the proper level of due diligence, [or] determined the potential exposure to risk” in the Sigue matter.<sup>504</sup>

Two months later, on April 26, 2008, a major U.S. newspaper published an article describing an ongoing Federal probe of allegations that Wachovia Bank was laundering drug proceeds supplied by Mexican casas de cambio.<sup>505</sup> The article also mentioned Sigue, triggering a second round of inquiries at HBUS into the status of the Sigue account which remained open at HBMX and continued to execute U.S. dollar transactions through the HBMX correspondent account at HBUS.

HBUS AML Compliance officer Judy Stoldt and HBUS investigator Gloria Stazza sent a memorandum to their supervisor Denise Reilly, a senior HBUS AML Compliance officer, summarizing the article and discussing HBUS’ exposure to the casas de cambio named in the article.<sup>506</sup> The memorandum began:

“HBUS does not hold any account for any casa de cambio mentioned in the WSJ article. The only HBUS connection to

<sup>501</sup> Id. HBUS apparently provided this wire transfer information to the OCC, in response to the OCC request for more information about HBUS’ involvement with Sigue.

<sup>502</sup> Id.

<sup>503</sup> Id.

<sup>504</sup> Id. at 1.

<sup>505</sup> See “Wachovia Is Under Scrutiny in Latin Drug-Money Probe,” *Wall Street Journal*, Evan Perez and Glenn Simpson (4/26/2008).

<sup>506</sup> See 5/1/2008 memorandum [carrying incorrect date of 5/1/2007] from HBUS Judy Stoldt and Gloria Stazza to HBUS Denise Reilly, “Wall Street Journal Article Regarding Wachovia,” OCC-PSI-01358516-517.



activity involving those named casas de cambio is activity that was conducted through our correspondent accounts, and most notably through our account with HSBC Bank Mexico (HBMX).<sup>507</sup>

The May 2008 memorandum described Sigue as a money service business that had allegedly processed \$24.7 million in “suspicious money remittances related to drug-trafficking proceeds.”<sup>508</sup> It explained that HBUS had first taken note of Sigue when it entered into a record \$25 million settlement with the Justice Department in January 2008, and, as a result, conducted a review of the Sigue accounts, wire transfer activity, and whether either Sigue or its founder, Guillermo de la Vina, had been “the subject of any other negative news or law enforcement activity.”<sup>509</sup> The memorandum reported that, despite having no direct account with Sigue, a “wire review” found that, during 2007, Sigue had sent 159 wire transfers for \$485 million through HBMX’s correspondent account, all of which were originated by Sigue and sent to its own account at HBMX, which HBUS viewed as suspicious.<sup>510</sup> The memorandum noted that HBUS had contacted HBMX to discuss Sigue, and HBMX disclosed that it had imposed “parameters” on its relationship with Sigue, including limiting Sigue to “conducting transactions for individual customers to \$2,000 USD per transaction.”<sup>511</sup> The memorandum did not explain, however, how that \$2,000 limit affected the actual wire activity in 2007, in which each wire transfer apparently batched numerous underlying wires without identifying individual client transactions. The memorandum also stated that HBUS had found that a Sigue employee had been indicted for assisting drug traffickers with money laundering,<sup>512</sup> and on another occasion Sigue was

<sup>507</sup> Id. at 1.

<sup>508</sup> Id. at 3. See also 1/28/2008 “Sigue Corporation and Sigue LLC Enter into Deferred Prosecution Agreement and Forfeit \$15 Million to Resolve Bank Secrecy Act Violations,” press release issued by U.S. Department of Justice, [http://www.justice.gov/opa/pr/2008/January/08\\_crm\\_068.html](http://www.justice.gov/opa/pr/2008/January/08_crm_068.html) (stating that “more than \$24.7 million in suspicious transactions were conducted through registered agents of Sigue, including transactions conducted by undercover U.S. law enforcement agents using funds represented to be proceeds of drug trafficking”).

<sup>509</sup> 5/1/2008 memorandum [carrying incorrect date of 5/1/2007] from HBUS Judy Stoldt and Gloria Stazza to HBUS Denise Reilly, “Wall Street Journal Article Regarding Wachovia,” OCC-PSI-01358516-517, at 3.

<sup>510</sup> Id. at 4. The memorandum did not mention that this wire analysis was compiled for the OCC, at its request, in February 2008. According to Sigue, altogether during 2007, it sent a total of more than \$1.8 billion in wire transfers through its HBMX account to a Sigue affiliate in Mexico. Subcommittee briefing by Sigue (7/25/2012).

<sup>511</sup> 5/1/2008 memorandum [carrying incorrect date of 5/1/2007] from HBUS Judy Stoldt and Gloria Stazza to HBUS Denise Reilly, “Wall Street Journal Article Regarding Wachovia,” OCC-PSI-01358516-517, at 4.

<sup>512</sup> Id. at 3. The Subcommittee has not obtained evidence of an instance in which a Sigue employee has been indicted for assisting drug traffickers with money laundering; however, in 2006, a Sigue agent pled guilty to money laundering and conspiracy to distribute illegal drugs, and a factual statement supporting his guilty plea described his use of Sigue wire transfers to launder illegal drug proceeds from 2003 to 2005. See United States v. Gerardo Alvarado Alvarado, Case No. 1:05CR354-1 (USDC MDNC), Plea Agreement (2/24/2006) and Factual Basis in Support of Guilty Plea (2/24/2006).

described as having allowed \$295,000 to be transferred from an account at another bank to an illegal alien deported to Mexico,<sup>513</sup> while also noting that Sigue itself had not been implicated in either matter. Despite this cascade of troubling information, for the next two years, little or no action appears to have been taken by HBUS or HBMX with respect to the Sigue account at HBMX.

On January 30, 2009, having determined that Sigue satisfied the requirements of the Deferred Prosecution Agreement the Justice Department requested and the court granted dismissal of the criminal case against the company.<sup>514</sup>

In 2010, as part of an OCC AML examination, an OCC AML examiner reviewed the May 2008 memorandum regarding Sigue and asked what followup actions had been taken in response to it, in particular whether Sigue had ever been added to the HBUS “wire filter” for purposes of enhanced due diligence and whether any further analysis had been done of Sigue account activity.<sup>515</sup> HBUS personnel responded that Sigue had not been added to the wire filter, the 2008 memorandum had not been “passed to anyone,” and the HBUS Financial Intelligence Group had not conducted any additional due diligence with respect to Sigue.<sup>516</sup> HBUS explained that “Sigue was not added to the wire filter as Sigue entered into a written agreement with the Department of Justice to enhance its AML program and was not (per the investigative search) the subject of any other money laundering investigations.”<sup>517</sup> Essentially, despite Sigue’s deferred prosecution in 2008, admission of wrongdoing caused in part by an inadequate AML program, past HBMX alerts flagging unusual transactions, past HBUS wire transfer analysis identifying suspicious activity, past recommendations by Compliance to close the account, and past regulatory inquiries, HBUS did not conduct any enhanced monitoring or analysis of the Sigue account.

<sup>513</sup> 5/1/2008 memorandum [carrying incorrect date of 5/1/2007] from HBUS Judy Stoldt and Gloria Stazza to HBUS Denise Reilly, “Wall Street Journal Article Regarding Wachovia,” OCC-PSI-01358516-517, at 3-4. The memorandum referred to an article as the source of this information. *Id.* at 3; see also “Suspicious wire transfers, documents lead to raids in NW Ark,” Associated Press, Jon Gambrell (5/25/2007). The referenced matter involves criminal proceedings in which the employee of a Sigue agent (who had been deported to Mexico) was charged with conducting an unlicensed money transmitting business and supporting illegal aliens in the United States; no drug proceeds were involved. See United States v. Honorato Pedrosa, Case No. 5:07-cr-50050-JLH (USDC WDAK), Indictment (6/27/2007).

<sup>514</sup> See United States v. Sigue Corp. and Sigue LLC, Case No. 4:08CR54 (USDC EDMO), Order for Dismissal with Prejudice (1/30/2009).

<sup>515</sup> See 2/16-18/2010 exchange of emails among Federal Reserve Patricia Brunner, HBUS Denis O’Brien, Judy Stoldt, and others and OCC Joseph Boss, “June 2008 Audit – Payment Services,” OCC-PSI-00378989.

<sup>516</sup> *Id.*

<sup>517</sup> 5/1/2008, memorandum [dated 5/1/2007, sic] from HBUS Judy Stoldt and HBUS Gloria Stazza to HBUS Denise Reilly, Re: Wall Street Journal Article Regarding Wachovia, OCC-PSI-01358517.

HBMX's relationships with Puebla and Sigue, a Mexican casa de cambio and a U.S. money service business that remitted funds to Mexico and Latin America, demonstrate its tolerance for high risk clients, and how those clients subjected, not only HBMX, but also HBUS to substantial money laundering risks. The accounts also disclose how both banks failed to conduct effective monitoring of some financial institution accounts and transactions, even when faced with evidence of lax AML controls and criminal proceedings involving money laundering. They also expose an absence of regular information sharing and coordinated AML efforts between HBUS and HBMX to address common AML problems, including limited communications about particular clients and actions taken to restrict or close accounts.

## **(2) Cayman Island U.S. Dollar Accounts**

A second example of high risk HBMX clients posing money laundering risks to HBUS are the tens of thousands of U.S. dollar accounts maintained by HBMX through its branch office in the Cayman Islands. This branch office is a shell operation with no physical presence in the Caymans, and is managed by HBMX personnel in Mexico City who allow Cayman accounts to be opened by any HBMX branch across Mexico. Total assets in the Cayman accounts peaked at \$2.1 billion in 2008. Internal documents show that the Cayman accounts had operated for years with deficient AML and KYC controls and information. An estimated 15% of the accounts had no KYC information at all, which meant that HBMX had no idea who was behind them, while other accounts were, in the words of one HBMX compliance officer, misused by "organized crime." Because a primary feature of the Cayman accounts is their use of U.S. dollars, HBMX has maintained the account assets and conducted account transactions through its U.S. dollar correspondent accounts at HBUS. There is no documentation showing that HBUS knew or was informed that, by providing HBMX with correspondent accounts, it was also providing access to the U.S. financial system to high risk accountholders in the Caymans. By moving the Cayman transactions through its HBUS accounts, HBMX exposed not only itself, but also HBUS to the money laundering risks inherent in its Cayman clients.

**Cayman Accounts.** HSBC acquired the Cayman branch through its purchase of Bital in November 2002. According to a letter from HSBC legal counsel:

"Bital received authorization from Mexican and Cayman authorities to offer Cayman USD [U.S. dollar] accounts to its customers in 1980. Bital's license and authorization to offer

Cayman USD accounts was inherited by HBMX when HSBC acquired Bital in 2002.”<sup>518</sup>

After the acquisition, the Cayman branch of Bital was renamed HSBC Mexico S.A. and continued to operate under a Cayman Class B banking license, restricting the branch to operating only “offshore” and open accounts exclusively for non-Cayman residents.<sup>519</sup> From its inception, the branch had no physical office or employees in the Cayman Islands, and operated in that jurisdiction solely as a shell entity.<sup>520</sup> The Cayman accounts were actually opened and maintained by HBMX personnel in Mexico. Any HBMX branch across Mexico had the authority to open a Cayman account for a client.<sup>521</sup>

To enable the Cayman branch to provide U.S. dollar accounts to clients, HBMX used its correspondent accounts at HBUS to supply the needed dollars, process U.S. dollar wire transfers, cash U.S. dollar travelers cheques, and perform similar U.S. dollar services. HBMX did not open a separate correspondent account for the Cayman branch, but included Cayman account transactions within its general correspondent account at HBUS. The documents and other evidence reviewed by the Subcommittee contain no indication that, until recently, HBMX ever informed HBUS about its Cayman branch or the Cayman U.S. dollar denominated accounts being serviced through the HBMX correspondent accounts at HBUS.<sup>522</sup>

The number of accounts and the volume of assets held in the Cayman accounts have fluctuated over time. Documentation associated with the 2002 Bital purchase do not indicate how many Cayman accounts then existed or the total amount of assets they held. A 2006 audit of the Cayman accounts reported just 1,500 accounts in 2005, with no mention of the account balances.<sup>523</sup> In September 2008, HBMX reported a remarkable increase, over 60,000 Cayman accounts for nearly

<sup>518</sup> 6/5/2012 letter from HSBC legal counsel to the Subcommittee, at 4.

<sup>519</sup> See, e.g., 7/31/2008 email from HSBC David Bagley to HSBC Richard Bennett, “HBMX-CAYMAN ACCOUNTS,” HSBC OCC 8874827-33. See also list of Cayman offshore banks at [http://www.offshore-library.com/banking/cayman\\_islands/page\\_3](http://www.offshore-library.com/banking/cayman_islands/page_3). According to HSBC, HBMX policy is not to offer the accounts to either Cayman or U.S. residents. See 6/5/2012 letter from HSBC legal counsel to the Subcommittee, at 5.

<sup>520</sup> See, e.g., 7/31/2008 email from HSBC David Bagley to HSBC Richard Bennett, “HBMX-CAYMAN ACCOUNTS,” HSBC OCC 8874827-33.

<sup>521</sup> See, e.g., 1/2006 “General Audit Report, HBMX – KYC of USD Current Accounts in Grand Cayman,” prepared by Group Audit Mexico, HSBC OCC 8874307-310, at 1. This audit reviewed files for Cayman accounts that had been opened by 26 HBMX branches in Mexico City. *Id.*

<sup>522</sup> Michael Gallagher, for example, who headed the HBUS PCM division that helped handle correspondent accounts, told the Subcommittee he had been unaware of the U.S. dollar Cayman accounts at HBMX. Subcommittee interview of Michael Gallagher (6/13/12).

<sup>523</sup> See 1/2006 “General Audit Report, HBMX – KYC of USD Current Accounts in Grand Cayman,” prepared by Group Audit Mexico, HSBC OCC 8874307-310, at 1.

50,000 customers, with total assets approaching \$2.1 billion.<sup>524</sup> Three years later, however, those totals dropped significantly. According to HSBC legal counsel, as of January 2012, the Cayman branch held about 24,000 Demand Deposit and Term Deposit Accounts for nearly 21,000 customers, with a total dollar value of approximately \$657 million.<sup>525</sup> About 9,000 Cayman accounts had been closed in 2009, due in part to insufficient Know Your Customer (KYC) information for the accounts as well as regulatory concerns about their high risk nature.

**Inherent Riskiness of Accounts.** HBMX and HSBC Group were well aware that the Cayman accounts had an inherently higher AML risk than other Mexican accounts, since they were offered in an offshore jurisdiction with strong secrecy laws and a limited tax regime, and permitted accountholders to hold assets in U.S. dollars in contravention of normal Mexican legal restrictions.

In 2008, HSBC Group Compliance head David Bagley noted in an email to senior HSBC Group officials that Mexican regulators knew of the Cayman accounts, which apparently circumvented certain Mexican banking regulations, but nevertheless allowed them to operate:

“The [Cayman] license, inherited from Bital, allows HBMX to provide USD-denominated services to persons domiciled in Mexico. Mexican regulation apparently prohibits individual Mexicans (i.e. non-corporate) to hold USD-denominated deposit accounts in Mexico. ... Although HBMX were recently fined USD50,000, for the inappropriate promotion of these services in Mexico, I am advised that CNBV are aware of the existence of the accounts and services and have raised no concerns.”<sup>526</sup>

Mr. Bagley also warned:

“There continues to be a real focus on the level of USD-denominated activity in Mexico by CNBV and other bodies, and the extent of HBMX’s activity in this area. This account base has to therefore be seen as high-risk from an AML and reputational perspective.”<sup>527</sup>

In November 2005, an email from HBMX Compliance head Ramon Garcia to senior HSBC Group Compliance officer John Root

<sup>524</sup> See chart at HSBC OCC 8876787, attached to 9/12/2008 email from HSBC John Root to HSBC Adrian Cristiani, “Cayman Accounts,” HSBC OCC 8876784.

<sup>525</sup> See 6/5/2012 letter from HSBC legal counsel to the Subcommittee, at 5.

<sup>526</sup> 7/31/2008 email from HSBC David Bagley to HSBC Richard Bennett, with copies to HSBC Michael Geoghegan, Matthew King, and HBMX Emilson Alonso, Luis Pena, and John Rendall, “HBMX-CAYMAN ACCOUNTS,” at HSBC OCC 8874832.

<sup>527</sup> Id.

flagging compliance issues at HBMX provided this explanation for the Cayman accounts:

“There is a Cayman Island branch for HBMX. Since there is a restriction by Mexican Law to open accounts to nationals in USD except for those residing in the Mexico’s border, as an alternative, [Bital] decided to open this branch where cheques accounts to Nationals could be opened in USD. It is also known that these USD accounts were issued also to non Mexican Nationals.”<sup>528</sup>

A January 2006 HBMX internal audit report explained the demand for the accounts this way: “HBMX offers their clients the option to open USD current and investment accounts in Grand Cayman so that clients profit [from] the advantages of that country, such as tax free investments, under confidentiality terms.”<sup>529</sup> In a 2007 email discussing the sale of cross-border financial products in Mexico, HSBC Group Compliance Deputy Head Warren Leaming also noted: “Because Mexico’s tax scheme is relatively penal (worldwide income) there is a high demand for off-shore products.”<sup>530</sup>

**Below Standard AML and KYC Controls.** The riskiness of the Cayman accounts was magnified by weak AML controls and inadequate KYC information. Those AML deficiencies meant that HBMX had little real knowledge about the customers using the Cayman accounts.

HSBC Group knew about the weak state of the Cayman AML and KYC controls from the time Bital was purchased in 2002, and it inherited the Cayman branch. An audit prior to the acquisition found that Bital had no functioning Compliance Department, limited client transaction and activity monitoring, and no KYC focus on high risk clients.<sup>531</sup> The audit specifically noted the poor state of KYC information in the Cayman accounts: “41% of the accounts reviewed (92 of 224 reviewed) lacked full client information. 37 files had no client information.”<sup>532</sup>

In 2004, Mexico strengthened KYC requirements for Mexican financial accounts and required Mexican banks to update the KYC information in all customer accounts by 2007. In January 2006, HBMX’s audit group conducted an audit of the KYC controls in place

<sup>528</sup> 11/22/2005 email from HBMX Ramon Garcia to HSBC John Root, “HBMX – COMPLIANCE ISSUES,” HSBC OCC 8873261.

<sup>529</sup> 1/2006 “General Audit Report, HBMX – KYC of USD Current Accounts in Grand Cayman,” prepared by Group Audit Mexico, HSBC OCC 8874307-310, at 1.

<sup>530</sup> 5/24/2007 email from HSBC Warren Leaming to HSBC David Bagley, “He advises that his own compliance team are advising him that such cross border activities should cease.-HBMX,” HSBC OCC 8875007.

<sup>531</sup> July 2002 “Group Internal Audit: Due Diligence Review – Project High Noon,” prepared by HSBC internal audit group, HSBC OCC 8873846-852.

<sup>532</sup> Id. at HSBC OCC 8873847.

for the Cayman accounts and rated them “**Below Standard.**”<sup>533</sup> Of the Cayman accounts reviewed, the audit found that 13% of the files lacked material KYC information; more than 50% lacked a visit report with the client; some foreign clients were incorrectly described as Mexican nationals; and 15% of the account files were missing altogether:

“More than 50% of account files that were reviewed lacked the relevant visit report, which weakens the position of HBMX in terms of KYC process for these types of accounts (Grand Cayman), particularly those accounts opened by foreigners. In addition, in 13% of files reviewed the visit reports failed to include material information enabling to have adequate KYC.

Weaknesses were noted in the supervision over the account opening process, which also impeded to detect promptly any information missing in account files or inconsistencies between the information produced by the client and the data captured in Cis-Hogan [HBMX data system]. ... In addition, the auditors identified foreign clients who were input to the system as nationals.

In addition to the foregoing, c[irca] 15% (10) of account files were not found at the Branches. No actions had appeared to be taken to instruct RMs [Relationship Managers] to complete client’s file again.

In particular the auditors identified that for accounts opened by foreign clients these had produced expired immigration forms and that Branch staff did not maintain a copy of all the pages composing such a document. This situation was due, in part, to the fact that circular letter Depvist045 (procedure to open current and term accounts) is not clear in the procedure to open these types of accounts (Grand Cayman).”<sup>534</sup>

The audit concluded with the recommendation: “Branch should ensure that KYC and account opening documentation is complete and in compliance with regulations.”<sup>535</sup>

The 2006 audit uncovered severe AML and KYC deficiencies in the Cayman branch requiring remedial action to comply with the Mexican deadline for improving customer file KYC information, but those audit results appear to have been ignored. The audit recommendations were recorded in HBMX’s electronic system, but later

<sup>533</sup> 1/2006 “General Audit Report, HBMX – KYC of USD Current Accounts in Grand Cayman,” prepared by Group Audit Mexico, HSBC OCC 8874307, at 1 (emphasis in original).

<sup>534</sup> Id. at 3.

<sup>535</sup> Id. at 4.

closed out without any apparent actions having been taken in response, which does not comport with Group policy.<sup>536</sup> Two years later, in 2008, John Root, senior HSBC Group Compliance officer, rediscovered the 2006 audit when examining KYC problems in the Cayman accounts. He wrote: “The real surprise was the existence of an HBMX audit in January 2006 on KYC for the USD Cayman accounts. It is not clear who in AML responded, and how. Blank looks all around.”<sup>537</sup> His supervisor, Mr. Bagley, later jokingly remarked to the Head of Group Audit for Latin America and the Caribbean, Graham Thomson: “I do find it surprising that there can have been no response and yet the audit was closed out. Is this a breach or are you in audit becoming softer.”<sup>538</sup>

**Project Restoration.** As the 2007 deadline approached for completing the KYC updates mandated by Mexican law and internal reports showed that HBMX’s KYC documentation remained in poor condition, HBMX obtained a year-long extension from Mexican regulators, to May 2008, to clean up its files, including client files for the Cayman accounts.<sup>539</sup>

In February 2008, Mexican regulators met with the HBMX CEO and, among other issues, criticized the bank’s poor KYC documentation, leading HBMX to initiate “Project Restoration” to intensify its KYC remediation efforts.<sup>540</sup> John Rendall, HBMX Chief Operating Officer, was put in charge of the project with the understanding that files containing inadequate KYC would be closed.<sup>541</sup> Project Restoration was closely monitored by senior HBMX and HSBC Group officials.

At first, the Cayman accounts were excluded from the project. Then, in July 2008, HBMX’s monitoring system suddenly began generating alerts for a number of Cayman accounts. These alerts, which highlighted suspicious account activity, were brought to the attention of senior Compliance personnel. The head of HSBC Group Compliance David Bagley told the Subcommittee this incident was the “first point that the Cayman Islands were brought into sharp focus” for him.<sup>542</sup> He sent an email informing senior HSBC Group and HBMX officials about the alerts which had identified “significant USD [U.S. dollar]

<sup>536</sup> See 7/30/2008 email from HSBC John Root to HSBC David Bagley, “HBMX Visit Update,” HSBC OCC 8873487-489; 8/5/2008 email exchange among HSBC David Bagley, HSBC John Root and HBMX Graham Thomson, “HBMX - Cayman accounts,” HSBC OCC 8874829-830.

<sup>537</sup> 7/30/2008 email from HSBC John Root to HSBC David Bagley, “HBMX Visit Update,” HSBC OCC 8873487-489.

<sup>538</sup> 8/5/2008 email from HSBC David Bagley to HBMX Graham Thomson, “HBMX Cayman accounts,” at HSBC OCC 8874829.

<sup>539</sup> See 7/27/2007 minutes of HSBC LAM Regional Audit Committee, HSBC OCC 8875086-090 (noting extension of time for the KYC effort until May 2008).

<sup>540</sup> See 6/5/2012 letter from HSBC legal counsel to the Subcommittee, at 2.

<sup>541</sup> See, e.g., 10/28/2008 email from Graham Thomson to Emilson Alonso, Subject: “HBMX – Projecto Restauracion,” HSBC OCC 8873464.

<sup>542</sup> Subcommittee interview of David Bagley (5/10/2012).



remittances being made by a number of [HBMX Cayman] customers to a US company alleged to be involved in the supply of aircraft to drug cartels.”<sup>543</sup> The company was Cabello Air Freight Inc. of Miami.<sup>544</sup> Mr. Bagley wrote that “[a]s a precaution HBMX have issued instructions that no new [Cayman] accounts be opened pending a review of these activities.”<sup>545</sup> This step was taken with respect to the Cayman accounts, in the words of one HBMX compliance officer, “due to the massive misuse of them by organized crime.”<sup>546</sup>

The decision to suspend new Cayman accounts was made by then HBMX CEO Luis Pena who did not specify when the suspension would be lifted.<sup>547</sup> He also instructed HBMX staff to engage in “a process of enhanced due diligence KYC” for all Cayman accountholders to “end by December 1.” He wrote:

“After this date we will cancel all the accounts that we were not able to complete files on and will send cashiers checks to all the respective customers. For the future, Mexicans who wish to open a dollar denominated account will undergo a referencing process, in which the accounts will be ... opened by the bank’s staff in a proper offshore book as we do in our Premier offering. ... Unfortunately we will likely lose some deposits as we do not expect the KYC process to succeed 100%, but we will offset a significant control and regulatory risk.”<sup>548</sup>

Also in July 2008, after reviewing the 2006 audit of the Cayman accounts, Mr. Root informed Mr. Bagley that “a sampling showed that 15% of the customers did not even have a file.”<sup>549</sup> Mr. Root wrote: “Fixing the Cayman accounts will be a struggle. How do you locate clients when there is no file?” Missing client files, combined with accounts misused by drug cartel operatives, provided stark evidence of the high risk character of the Cayman accounts and the need for HBMX

<sup>543</sup> 7/31/2008 email from HSBC David Bagley to HSBC Richard Bennett, with copies to HSBC Michael Geoghegan, Matthew King, and HBMX Emilson Alonso, Luis Pena, and John Rendall, “HBMX-CAYMAN ACCOUNTS,” HSBC OCC 8874832-33.

<sup>544</sup> See also Sealed Exhibits.

<sup>545</sup> 7/31/2008 email from HSBC David Bagley to HSBC Richard Bennett, with copies to HSBC Michael Geoghegan, Matthew King, and HBMX Emilson Alonso, Luis Pena, and John Rendall, “HBMX-CAYMAN ACCOUNTS,” HSBC OCC 8874832-33.

<sup>546</sup> 11/27/2008 email from HBMX employee to HBMX Jaime Saenz and Ramon Garcia, “Seriously consider restricting the product Dollars accounts in the zona frontera Product 63,” HSBC OCC 8875736-738.

<sup>547</sup> See 7/31/2008 email from HBMX Luis Pena to HBMX Emilson Alonso, HSBC David Bagley, and others, “HBMX - CAYMAN ACCOUNTS,” HSBC OCC 8873503-504. See also undated HSBC presentation, “Conducting an Enhanced KYC for Grand Cayman Accountholders: Proposal to Update the Strategy to Control Risk arising from Grand Cayman Accounts,” HSBC OCC 8874561.

<sup>548</sup> 7/31/2008 email from HBMX Luis Pena to HBMX Emilson Alonso, HSBC David Bagley, and others, “HBMX - CAYMAN ACCOUNTS,” HSBC OCC 8873503-504.

<sup>549</sup> 7/30/2008 email from HSBC John Root to HSBC David Bagley, “HBMX Visit Update,” HSBC OCC 8873487-489.

to get a better sense of the clients using them. In the meantime, the documents contain no indication that either HSBC Group or HBMX informed HBUS about the suspect account activity or the Cayman KYC deficiencies, even though the Cayman accounts were operating solely through the HBMX correspondent accounts at HBUS.<sup>550</sup>

As a result of the AML alerts regarding money laundering involving some of the Cayman accounts and re-discovery of the 2006 audit exposing the poor state of the Cayman account files, the Cayman accounts were added to the Restoration Project.<sup>551</sup> Mr. Root told the Subcommittee that, in July 2008, the Cayman accounts “went to the top of the list” at the project.<sup>552</sup>

One of the first steps taken with regard to the Cayman accounts was that HBMX Compliance personnel analyzed their risk levels, and sorted customers into three categories: red, yellow, and white. Red status indicated that a customer was a “Special Category Client” (SCC), on a “black list,” or the subject of a SAR; yellow status indicated that a customer had been flagged by HBMX’s internal AML monitoring system with one or more alerts, but no SAR had been filed; white status indicated that the customer had no such derogatory information on file.<sup>553</sup> Out of a total of 49,935 customers with 61,586 accounts worth about \$2.1 billion, HBMX categorized 1,314 customers as “red” status, representing 2,240 accounts worth about \$205 million. HBMX also flagged 2,027 customers as “yellow” status, representing 2,084 accounts worth about \$180 million.<sup>554</sup> HBMX then largely limited its KYC remediation efforts to the 3,341 “red” and “yellow” customers. The other 46,000 accountholders were not included in the project.<sup>555</sup>

Two months later, in September 2008, senior HSBC Group Compliance officer John Root offered a negative assessment of the KYC remediation efforts directed at the Cayman accounts:

<sup>550</sup> Another example of a Cayman U.S. dollar account that HSBC Group and HBMX were aware of and expressed concerns about, but apparently did not inform HBUS, were accounts opened for two embassies, one of which was for a country in the Middle East. See 12/2/2005 email exchange between HSBC David Bagley and John Root, “OFAC,” HSBC OCC 8876612-613. Mr. Bagley told the Subcommittee that although there was no indication of any “sinister” activity, these accounts were later closed, because the bank “did not want the risk.”

Subcommittee interview of David Bagley (5/10/12).

<sup>551</sup> Subcommittee interview of David Bagley (5/10/12).

<sup>552</sup> Subcommittee interview of John Root (4/26/12).

<sup>553</sup> See 9/12/2008 email from HBMX Ramon Garcia to HSBC John Root, “Cayman Accounts,” HSBC OCC 8876784.

<sup>554</sup> See Attachment to 9/12/2008 email from HBMX Ramon Garcia to HSBC John Root, “Cayman Accounts,” HSBC OCC 8875462-465, at 465.

<sup>555</sup> See undated HSBC presentation, “Conducting an Enhanced KYC for Grand Cayman Accountholders: Proposal to Update the Strategy to Control Risk arising from Grand Cayman Accounts,” HSBC OCC 8874560-566, at 561 (“It is considered that it will not be possible to complete 50,000 enhanced KYC by 01DEC08.”).

“The HBMX ‘Restoration’ project chaired by John Rendall, HBMX COO, is endeavoring to regularize these accounts on a risk-basis. Account opening documentation is generally poor or non-existent and there is a lot of work to do. Money-laundering risk is consequently high.”<sup>556</sup>

An HSBC presentation, which is undated but appears to have been prepared in October 2008, summarized the ongoing Cayman KYC problems and presented a new strategy to address them.<sup>557</sup> The presentation was entitled, “Conducting an Enhanced KYC for Grand Cayman Accountholders: Proposal to Update the Strategy to Control Risk arising from Grand Cayman Accounts.”<sup>558</sup> One key slide noted that “almost no progress [had] been made in enhanced KYC completion” and that only 25% of the files would have complete KYC information by December 1, 2008:

- “The Bank has been recently been fined for offering this product in Mexico, and money laundering red flags have been identified.

- On 28JUL, CMP [Compliance] gave instructions to suspend this product.

- On 31JUL08, Segment Directors were requested by CEO that an enhanced KYC will be completed for all Grand Cayman accounts before 01DEC08.

- As of JUL08, in Grand Cayman CDA/DDA 49,937 customers, and its portfolio was approximately USD 1,500 million.<sup>559</sup>

- Currently, this product is expected to be re-opened, as long as necessary adjustments to systems, processes and documentation are made, with stricter controls, and if Group Compliance’s sign-off is obtained.

- On 26SEP, Segment directors reported that almost no progress has been made in enhanced KYC completion. In addition, a central validation of enhanced KYC quality is not in place.

<sup>556</sup> 9/12/2008 email from HSBC John Root to Adrian Cristiani and others, “Cayman Accounts,” HSBC OCC 8875462-465, at 462.

<sup>557</sup> Undated HSBC presentation, “Conducting an Enhanced KYC for Grand Cayman Accountholders: Proposal to Update the Strategy to Control Risk arising from Grand Cayman Accounts,” HSBC OCC 8874560-566. Because of dates mentioned in the presentation, it seems to have been completed between September 27 and October 30, 2008.

<sup>558</sup> Undated HSBC presentation, “Conducting an Enhanced KYC for Grand Cayman Accountholders: Proposal to Update the Strategy to Control Risk arising from Grand Cayman Accounts,” HSBC OCC 8874560.

<sup>559</sup> The figure of \$1,500 million seems to refer to the Cayman certificates of deposit and does not include additional funds in Cayman Demand Deposit Accounts.

- According to Remediation Project results, success rate in file completion is approximately 25%. This means that if this strategy is followed, it will not be possible to complete more than 25% of required enhanced KYC forms by 01DEC08.”<sup>560</sup>

This October 2008 assessment indicates that at least 75% of the Cayman files still had incomplete KYC information six years after HBMX assumed control of the accounts.

Despite this grim assessment, the Strategy also noted efforts underway to allow new Cayman accounts to be opened.<sup>561</sup> As Graham Thomson, head of Group Audit for Latin America and the Caribbean, explained in an email to colleagues, the accounts needed to continue due to the income they produced:

“Currently the business owner and compliance are still discussing with GMO CMP [Compliance] the product parameters that are to be applied to lift the current embargo and relaunch the CI [Cayman Island] product. It is important that these discussions result in practical product parameters as the CI portfolio is an important source of funds for HBMX and it is hoped the replacement product will be shortly submitted to the new products committee and then relaunched.”<sup>562</sup>

Internal documents show that HSBC Group and HBMX officials considered a variety of criteria to determine when a new Cayman account could be opened, including requirements that the client be an existing HBMX customer for six months, complete an “enhanced KYC Questionnaire,” undergo screening against the OFAC list and other “blacklists,” and agree to limits on cash deposits.<sup>563</sup>

**U.S. Dollar Restriction.** In November 2008, HSBC Group CEO Michael Geoghegan traveled to Mexico and met with senior Mexican regulators who were highly critical of HBMX’s AML and KYC efforts, the huge volume of U.S. dollars that HBMX was exporting to the United States, and the possibility that a portion of those funds were associated with drug trafficking and money laundering.<sup>564</sup> The regulators explicitly

<sup>560</sup> Undated HSBC presentation, “Conducting an Enhanced KYC for Grand Cayman Accountholders: Proposal to Update the Strategy to Control Risk arising from Grand Cayman Accounts,” HSBC OCC 8874560-566, at 561.

<sup>561</sup> Id. at 561.

<sup>562</sup> 10/20/2008 email from Graham Thomson to HSBC Emilson Alonso and others, “HBMX – Proyecto Restauracion,” HSBC OCC 8874595-600, at 596-597.

<sup>563</sup> See Sept.-Oct. 2008 email exchanges among HBMX Ramon Garcia, John Rendall, Maria Salazar and HSBC David Bagley, Warren Learning, Susan Wright, John Root, and Adrian Cristiani, HSBC OCC 8875818-829, at 829.

<sup>564</sup> See 2/18/2008 email from HBMX Paul Thurston to HSBC Michael Geoghegan, with copies to Richard Bennett and Matthew King, “Confidential – CMBV/FIU Meeting,” HSBC OCC

mentioned the U.S. dollars sent from the Cayman accounts.<sup>565</sup> In response, Mr. Geoghegan proposed prohibiting all HMBX branches, including the Cayman branch, from offering U.S. dollars to customers, except at automated teller machines in Mexican airports.<sup>566</sup> Since the Cayman accounts relied on U.S. dollars, the proposed new policy directly impacted Cayman accountholders. HBMX CEO Luis Pena nevertheless agreed with the proposal, and also ordered the freeze on opening new Cayman accounts to continue indefinitely and prohibiting new cash deposits for existing Cayman accounts.<sup>567</sup> Mr. Pena noted that the new measures would cost HBMX a lot of money: "Cayman and Mexico dollar accounts provide us with US\$2.6 billion of cheap funding. We are likely to lose a big portion of this if we tell customers we no longer receive dollar notes."<sup>568</sup> The new policies took effect in January 2009.

**9,000 Accounts Closed.** According to HSBC's legal counsel, HBMX took nearly another year to complete KYC remediation of the Cayman accounts, finally completing the work in July 2009.<sup>569</sup> As part of that KYC effort, HBMX closed approximately 9,000 Cayman accounts, due in many cases to incomplete KYC information.<sup>570</sup> At the same time, HBMX allowed the Cayman branch to remain in operation and lifted the ban on new accounts. Today, over 20,000 HBMX clients have over \$657 million in Cayman U.S. dollar denominated accounts.

Because the HBMX Cayman branch continues to offer U.S. dollar accounts, despite a history of poor KYC controls and deficient KYC documentation, and despite the inherent riskiness associated with operating offshore accounts in a secrecy tax haven, the Cayman accounts continue to pose ongoing money laundering risks to HBUS. Because HBUS is now aware of the Cayman accounts, it will have to evaluate the risk and determine whether to continue to process Cayman account transactions through the HBMX correspondent account.

### (3) Cashing U.S. Dollar Travelers Cheques

A third example of how HBMX has introduced risk into HBUS involves its issuing and cashing millions of dollars in U.S. dollar

8873331-333; 2/18/2008 draft report entitled, "Internal Control, HBC Mexico, S.A.," prepared by CNBV, HSBC OCC 8966021-026.

<sup>565</sup> See, e.g., 11/26/2008 email from HSBC David Bagley to HSBC Richard Bennett and Warren Leaming, "Mexico," HSBC OCC 8875605-607, at 607.

<sup>566</sup> See 11/26/2008 email from HSBC Michael Geoghegan to HBMX Emilson Alonso, "Money Laundering," HSBC OCC 8874849-850.

<sup>567</sup> See 11/27/2008 email from HSBC Warren Leaming to HSBC David Bagley and Richard Bennett, "Mexico," HSBC OCC 8875605-607, at 606.

<sup>568</sup> 11/28/2008 from HBMX Luis Pena to HSBC Emilson Alonso, HSBC OCC 8874856.

<sup>569</sup> 6/5/2012 letter from HSBC legal counsel to the Subcommittee, at 5.

<sup>570</sup> Id.

travelers cheques through its correspondent accounts at HBUS, at times under suspicious circumstances.

Travelers cheques are paper monetary instruments which, for a fee, are issued and administered by a financial institution. They can be issued in a variety of currencies and denominations, and carry serial numbers so that, if the cheques are lost or stolen, the issuing financial institution can trace back the purchase and either replace the cheques or refund the money used to purchase them. Individuals often use travelers cheques to minimize carrying hard currency while traveling and as a way to safeguard their funds. Some financial institutions issue such cheques only to pre-existing customers; others issue the cheques to anyone who pays the fee. U.S. financial regulators have long warned financial institutions about the money laundering risks associated with travelers cheques, especially when purchased with cash by a non-customer and used to move substantial funds across international borders in ways that are difficult to trace.<sup>571</sup> Travelers cheques have been used by terrorists,<sup>572</sup> drug traffickers,<sup>573</sup> and other criminals.<sup>574</sup>

HBMX has issued a large number of U.S. dollar travelers cheques, at times selling them to anyone willing to pay the fee and cashing them for customers and non-customers alike. In 2004, John Root, senior HSBC Group Compliance officer, sent an email to HBMX's Compliance head, Ramon Garcia, and AML head, Carlos Rochin, noting the huge volume of travelers cheques pouring in from Mexico and seeking assurances that HBMX was on guard against money laundering:

<sup>571</sup> See, e.g., Federal Financial Institutions Examination Council (FFIEC) Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Examination Manual, "Core Overview: Purchase and Sale of Monetary Instruments," (6/23/2005) at 59; FFIEC BSA/AML Examination Manual, "Purchase and Sale of Monetary Instruments-Overview," (8/24/2007) at 212 ("The purchase or exchange of monetary instruments at the placement and layering stages of money laundering can conceal the source of illicit proceeds. As a result, banks have been major targets in laundering operations because they provide and process monetary instruments through deposits.").

<sup>572</sup> See, e.g., United States v. al-Haramain Islamic Foundation Inc., Case No. 6:05-cr-60008-HO (USDC Oregon) Indictment (2/17/2005); "Former U.S. Head of Al-Haramain Islamic Foundation Sentenced to 33 Months in Federal Prison," U.S. Attorney's Office for the District of Oregon press release (9/27/11) at 1 (describing how the convicted defendant cashed \$130,000 in U.S. dollar travelers cheques at a bank in Saudi Arabia and then provided the funds to support violent extremists in Chechnya).

<sup>573</sup> See, e.g., United States v. Wachovia Bank N.A., Case No. 10-20165-CR-Lenard (USDC SDFL), Factual Statement, Exhibit A to Deferred Prosecution Agreement (3/16/2010), at ¶ 35 (describing how Wachovia Bank processed \$20 million in suspicious travelers cheques, some portion of which was suspected to include illegal drug proceeds); "How a Big U.S. Bank Laundered Billions from Mexico's Murderous Drug Gangs," The Guardian, (4/2/2011), <http://www.guardian.co.uk/world/2011/apr/03/us-bank-mexico-drug-gangs>. See also Albajon v. Gugliotta, 72 F. Supp. 2d 1362, 1365 (S.D. Fla. 1999) (admitting travelers cheques as evidence of drug trafficking proceeds); United States v. \$41,305.00 in Currency & Travelers Checks, 802 F.2d 1339, 1343 (11th Cir. 1986) (finding travelers cheques could be seized as drug trafficking proceeds).

<sup>574</sup> See, e.g., Folk v. State, 192 So. 2d 44, 46 (Fla. Dist. Ct. App. 1966) (upholding conviction for signing a false name on travelers cheques and cashing them); United States v. Sebagala, 256 F.3d 59, 63 (1st Cir. 2001) (upholding conviction for using undeclared travelers cheques to attempt to move money fraudulently through U.S. customs).

"I note that in the year through 3Q04 [third quarter of 2004], HBMX has sold over USD 110 million of travelers cheques, an amount that eclipses that of HBEU [HSBC Europe] here in the UK, and that is several orders of magnitude higher than any other non-UK entity, including Hong Kong and the US. In fact, it represents one-third of the Group's total global traveller's cheque business (with the UK representing another third).

Could you kindly prepare a report for GHQ [Group Headquarters] summarizing the money laundering procedures currently in place for such a booming business. Please include in this report KYC controls, number of SARs in the YTD [year to date], breakdown by region and branch, etc., etc."<sup>575</sup>

Mr. Garcia responded with preliminary information and a recent case involving travelers cheques, but in response to Mexican legal requirements regarding client-specific information, HSBC has so heavily redacted copies of those documents, as well as a longer report requested by Mr. Root, that they do not provide additional information.<sup>576</sup>

In 2008, when HBMX decided to stop offering U.S. dollars at its branches in most cases, the HBMX CEO Luis Pena recommended greater use of U.S. dollar travelers cheques instead, sold only to pre-existing customers.<sup>577</sup> In response, the Deputy Head of HSBC Group Compliance, Warren Leaming, warned that travelers cheques also raise AML concerns, and advised lowering the existing \$25,000 ceiling on the amount of travelers cheques that could be purchased by one customer at a time, and creating a new limit on the amount of travelers cheques that could be deposited at one time to a client account.<sup>578</sup>

In 2009, after CNBV expressed concerns about HBMX's weak AML controls, among other steps, HBMX tightened its policies on travelers cheques. As of January 1, 2009, HBMX determined that it would sell its travelers cheques only to pre-existing customers and would place a limit on the amount that could be sold to any one

<sup>575</sup> 11/8/2004 email from HSBC John Root to HBMX Ramon Garcia and Carlos Rochin, with copies to HSBC David Bagley and Susan Wright, "Travellers Cheques," HSBC OCC 8876645-646.

<sup>576</sup> See 11/30/2004 email from HBMX Ramon Garcia to HSBC John Root, David Bagley, Susan Wright, and HBMX Carlos Rochin, "Travellers Cheques," HSBC OCC 8876645-664.

<sup>577</sup> See 11/27/2008 email from HBMX Luis Pena to HBMX Emilson Alonso, copy to HSBC Michael Geoghegan, "Money Laundering," HSBC OCC 8874849.

<sup>578</sup> See 12/8/2008 email from HSBC Warren Leaming to HBMX Ramon Garcia and John Rendall with copies to HSBC David Bagley, John Root, Susan Wright, and others, "Mexico Visit," HSBC-PSI-PROD-0197874-876.

customer at a time.<sup>579</sup> Warren Leaming, Deputy Head of HSBC Group Compliance, who supported those changes, noted in an email: “There remain AML issues in respect of travellers cheques which historically are very high risk from an AML perspective and accordingly we would expect that the limits are reasonably low and that there are very strong controls in place to ensure that branches do not abuse the rules.”<sup>580</sup>

At HBUS, the documents reviewed by the Subcommittee indicate that, despite their large volume, HBMX travelers cheques attracted little AML review or attention, even though the travelers cheques would have been presented for payment at HBUS’ processing centers in New York and subjected to review. The HBUS processing centers segregated and reviewed all travelers cheques and were required to send blocks of sequentially numbered cheques exceeding \$10,000 to HBUS AML Compliance for review.<sup>581</sup> At the same time, the processing centers had no information on expected account volume, conducted no trend analysis to identify suspicious transactions, and conducted no due diligence on the persons cashing the cheques.<sup>582</sup> A 2007 OCC examination of HBUS’ pouch activities, which included clearing U.S. dollar travelers cheques, identified numerous deficiencies in the AML policies and procedures and called for stronger AML controls, but it did not appear to result in any greater review of the HBMX travelers cheques.<sup>583</sup> To the contrary, a 2007 HBUS policy change appears to have further limited AML reviews of travelers cheques presented by HSBC Group affiliates in non-high risk countries, restricting them to cases where the deposits exceeded \$1 million.<sup>584</sup> At that time, HBUS deemed both Mexico and HBMX to be at low risk of money laundering.

In 2009, the OCC conducted a second review of HBUS’ pouch activities, including procedures to clear U.S. dollar travelers cheques.<sup>585</sup>

<sup>579</sup> 12/8/2008 email from HSBC Warren Leaming to HBMX Ramon Garcia and John Rendall, with copies to HSBC David Bagley, Susan Wright, John Root, and others, “Mexico Visit,” HSBC-PSI-PROD-0197874-876.

<sup>580</sup> Id.

<sup>581</sup> See 6/26/2008 OCC memorandum, “Pouch Transactions – Hokuriku Bank and SK Trading Company Ltd,” OCC-PSI-00885828, at 1 [Sealed Exhibit]. HBUS’ AML policies and procedures regarding travelers cheques are discussed in more detail in the Report Section on Hokuriku Bank: Cashing Bulk Travelers Cheques, *supra*.

<sup>582</sup> See 4/27/2007 email from HBUS Robert Guthmuller to HBUS Alan Ketley, “Visit to Brooklyn OpsLink,” OCC-PSI-00312153, at 4.

<sup>583</sup> See 3/31/2007 OCC Report of Examination, OCC-PSI-00304077 [Sealed Exhibit]; 9/13/2007 OCC Supervisory Letter, “Pouch Services and Middle Market at HBUS,” OCC-PSI-00000391-394. [Sealed Exhibit.]

<sup>584</sup> See 5/7/2007 email from HUBS George Tsugranes to HBUS Alan Ketley and others, “Visit to Brooklyn Ops,” OCC-PSI-00312153, at 3.

<sup>585</sup> See, e.g., 2/15/2010 email from HBUS Jane Burak to HBUS Lesley Midzain, “Advice Requested,” OCC-PSI-00256833 (describing banknotes examination that included reviews of travelers cheques); 2/11/2010 minutes of a “OCC & Chicago FED update Meeting,” prepared by HSBC, OCC-PSI-00256916 (noting that HSBC made a presentation to the OCC on 2/9/2010, on enhancements to its cash letter process and an “internal look-back of cash letter activity for Travelers Checks and Money Orders”).



As part of that examination, HBUS produced to the OCC a lengthy description of its AML policies and procedures for foreign financial institutions that present items for processing through a correspondent account, including travelers cheques.<sup>586</sup> Those procedures contained a number of restrictions or conditions, but did not impose a ceiling on the amount of money that HBUS would provide to a correspondent client through the cash letter process. The procedures did, however, require transactions over a certain amount to be reported to HBUS AML Compliance before processing. The reporting triggers were linked to the risk rating of the foreign financial institution presenting the monetary instrument for payment. The five relevant risk ratings, from highest risk to lowest, were: Special Category Client (SCC), high risk, cautionary risk, medium risk, and standard risk. The reporting triggers were as follows:

For SCC customers – \$1,000 for an individual item, and \$10,000 in total deposits.

For high risk customers – \$10,000 for an individual item, and \$100,000 in total.

For cautionary risk customers – \$50,000 for an individual item, and \$200,000 in total.

For standard and medium risk customers – \$50,000 for an individual item and \$250,000 in total.

Clients seeking to cash travelers cheques in excess of the reporting thresholds were not automatically prohibited from proceeding; instead, their transactions were reported to HBUS AML Compliance which was then supposed to make a case-by-case decision on whether to allow the transactions to proceed.

By 2009, Mexico and HBMX were considered high risk and, due to the large volume of HBMX travelers cheques it sold, HBMX cheques should have regularly triggered the AML reporting requirement and AML reviews. In addition, HBMX travelers cheques should have produced numerous alerts due to the large amounts, sequentially numbered cheques, and structuring patterns involved. Instead, the documentation suggests that few alerts issued and very little review of HBMX travelers cheques took place.

As part of its 2009 examination, the OCC expressed concern that, based on samples taken from 2007, 2008, and 2009, HBUS' monitoring of travelers cheques required too few AML reviews and was inadequate

<sup>586</sup> See undated "Request No. 7," prepared by HSBC, OCC-PSI-00000075-195 at 123-130 (providing detailed information in response to OCC questions regarding HBUS' remote deposit capture and cash letter pouch transactions). [Sealed Exhibit.]

to detect suspicious activity.<sup>587</sup> In response, HBUS undertook a detailed review of all cash letter items in 2009.<sup>588</sup> HBUS determined that 280 items had been flagged for review, a tiny number in comparison to the huge number of transactions cleared per year. In addition, according to HBUS, of those 280 items, less than a handful contained information suggesting suspicious activity.<sup>589</sup> While HBUS presented that result as evidence of minimal AML risk, it is possible that the criteria used to flag transactions for review were too narrow to catch suspicious transactions.

One reason to think the latter might be the case is that, from 2007 to 2012, other financial institutions have reported significant instances of suspicious activities involving U.S. dollar travelers cheques either issued or cleared by HBMX.<sup>590</sup> These reports generally describe coordinated teams of individuals, each of whom purchased large numbers of travelers cheques from HBMX, and then cashed or deposited the cheques in suspicious patterns. Some of the U.S. dollar travelers cheques identified by these financial institutions had a combined value in excess of \$1 million, and some of the suspicious activity occurred over an extended period of time. Many of the suspicious transactions involved sequentially numbered cheques, illegible signatures, or difficult to understand markings or numbers on the cheques. In some cases, groups of cheques were made payable to the same health food business, toy company, or automobile auction house.

Four examples illustrate the issues. In the first example, nearly 1,500 U.S. dollar travelers cheques were purchased from the same HBMX branch in Mexico over a seven-month period from 2007 to 2008, and cashed shortly thereafter at several automobile auctions in the United States. Money launderers have been shown in the past to utilize the purchase of expensive, but liquid items, such as cars to hide illicit funds. The travelers cheques had a combined value of \$900,000. In a second instance from 2008, on four occasions over a period of 16 days, individuals purchased from an HBMX branch in Mexico travelers cheques which, each time, had a combined value of \$20,000 to \$30,000, and altogether added up to \$109,000. All of the cheques were then signed and countersigned with the same illegible signature, and made payable to the same toy business in Mexico. Ten months later, in a coordinated effort over a two-week period, all of the cheques were either cashed or deposited. In a third instance, 188 travelers cheques in denominations of \$500 and \$1000, totaling \$110,000, were purchased in nine large blocks of sequentially numbered cheques from a major U.S. bank. Then, over a three-month period from April to June 2011, all 188

<sup>587</sup> See 2/15/2010 email from HBUS Janet Burak to HBUS Lesley Midzain, "Advice Requested," OCC-PSI-00256833.

<sup>588</sup> Id.

<sup>589</sup> Id.

<sup>590</sup> See Sealed Exhibits.

cheques were negotiated for payment at the same HBMX branch in Mexico, using illegible signatures so that the cheques provided no information about the payees.

In the fourth instance, two men purchased groups of travelers cheques from the same HBMX branch in Mexico. On 14 occasions over a three month period in 2011, the two men purchased the travelers cheques in batches which, each time, had a combined value of \$10,000, and altogether added up to \$140,000. All of the cheques were then signed with the same illegible signature. Over time, small groups of the travelers cheques, often with consecutive serial numbers, were cashed or deposited, with the majority of cheques failing to bear a stamp indicating exactly where they were negotiated. The 2011 transactions were part of a larger pattern in which the same HBMX branch sold travelers cheques to the same two men over a three year period from 2009 to 2011, for a combined value of \$1.9 million.

While HBMX has tightened its travelers cheque policies by restricting the sale of travelers cheques to pre-existing customers and limiting the dollar amount of travelers cheques that can be provided to one customer at a time, HBMX travelers cheques continue to surface in reports of suspicious activities filed with U.S. authorities. Because many if not all of the cheques are cashed through the HBMX correspondent accounts at HBUS, HBMX continues to expose HBUS to money laundering risks through its issuance and cashing of U.S. dollar travelers cheques.

HBMX's money service business clients, Cayman accountholders, and travelers cheque purchasers all relied on the U.S. dollar services that HBMX was able to provide through its correspondent accounts at HBUS. In some cases, it appears those HBMX clients used HBMX's U.S. dollar correspondent account at HBUS to commit criminal acts. For its part, HBUS should have known of the money laundering risks it was incurring from those and other high risk HBMX clients, accounts, and products. Because HBMX was an HSBC affiliate and was also categorized for many years as located in a low risk jurisdiction, however, until recently, HBUS did not perform the KYC due diligence or account monitoring needed to uncover HBMX's high risk activities.

#### **E. Bulk Cash Movements**

In addition to using HBUS correspondent accounts to execute wire transfers, clear cash letter instruments, and conduct other U.S. dollar transactions, in 2007 and 2008, HBMX used its HBUS banknotes account to supply more physical U.S. dollars to HBUS than any other Mexican bank or HSBC affiliate. The documents indicate that both HBMX and HBUS were unaware of the flood of dollars HBMX was

pouring into the United States through HBUS, in part because HBUS had stopped monitoring HSBC affiliates' banknotes accounts for a three-year period, from mid-2006 to mid-2009. HBUS policy was also consistent with the HSBC Group policy of not performing due diligence or account monitoring for HSBC affiliates. When, in 2008, Mexican and U.S. regulators began pressing both HBMX and HBUS to explain the huge flow of U.S. dollars from Mexico and whether the funds included illegal drug proceeds, both banks were caught by surprise and eventually took action to turn off the spigot. In 2009, HBMX stopped accepting U.S. dollar deposits at its branches in Mexico, and then in 2010, HBUS exited the banknotes business.

### (I) HBUS' Global Banknotes Business

Prior to its exit, HBUS operated a very large U.S. banknotes business which the Federal Reserve estimated in 2010, to be worth approximately \$300 billion annually.<sup>591</sup> As part of that business, HBUS supplied physical U.S. dollars and accepted bulk cash shipments from financial institutions around the world, including over two dozen HSBC affiliates.<sup>592</sup>

Bulk cash shipments typically use common carriers, independent carriers, or U.S. Postal Service carriers to ship U.S. dollars by air, land, or sea to a bank located in the United States.<sup>593</sup> Shipments have gone via airplanes, armored trucks, ships, and railroads. Most shipments are transported via containerized cargo. Shippers may be "currency originators," such as businesses that generate cash from sales of goods or services; or "intermediaries" that gather currency from originators or other intermediaries to form large shipments. Intermediaries are typically central banks, commercial banks, money service businesses, or their agents.<sup>594</sup> Bulk cash shipments can be made directly to a bank in the United States, or to a U.S. Federal Reserve Bank or branch, which will accept the cash and credit it to the account of the intended recipient bank.<sup>595</sup> Banks that receive bulk cash shipments via common carriers or the Postal Service have no obligation to report the amount of the cash received to U.S. authorities, though they still must report any suspicious activity.<sup>596</sup>

<sup>591</sup> 1/12/2010 memorandum from the Federal Reserve, "US Department of Justice Investigation of HSBC Bank USA NA's ('HSBC Bank USA') Bank Note Business (Revised)," BOG-SR-000442-443, 001402-409. [Sealed Exhibit.]

<sup>592</sup> See 9/13/2010 OCC Supervisory Letter HSBC-2010-22, OCC-PSI-00864335-365, at 342. [Sealed Exhibit.]

<sup>593</sup> 1/12/2010 memorandum from the Federal Reserve, "US Department of Justice Investigation of HSBC Bank USA NA's ('HSBC Bank USA') Bank Note Business (Revised)," at BOG-SR-001404. [Sealed Exhibit.]

<sup>594</sup> Id.

<sup>595</sup> Id.

<sup>596</sup> Id., citing 31 CFR §103.23.

Until 2010, HBUS was one of about 30 U.S. financial institutions that bought and sold physical currency on a wholesale basis around the world.<sup>597</sup> The headquarters of HBUS' Global Banknotes business was located in New York, headed by Christopher Lok, with offices in London, Hong Kong, Singapore, and other locations.<sup>598</sup> Until 2010, HSBC was also one of a relatively small number of international banks that contracted with the Federal Reserve Bank of New York (FRBNY), under the Extended Custodial Inventory (ECI) Program, to manage the FRBNY's U.S. currency vaults. The ECI Program facilitates the international distribution of U.S. dollars, repatriates old dollars, circulates new designs, and provides information on the international use of U.S. currency.<sup>599</sup> HSBC operated FRBNY currency vaults in London, Frankfurt, and Singapore.<sup>600</sup> The currency in those vaults remained on the books of the Federal Reserve, and was used to fill orders from third parties or the operator itself.<sup>601</sup> When distributing U.S. dollars, HSBC was obligated to comply with U.S. AML and Office of Foreign Assets Control (OFAC) requirements.<sup>602</sup>

While bulk cash shipments are a normal and legitimate part of international banking, they are also vulnerable to misuse by money launderers and other criminals. In 2001, the U.S. Congress made smuggling large amounts of physical U.S. dollars across U.S. borders a crime.<sup>603</sup> In 2005, a U.S. Money Laundering Threat Assessment identified bulk cash smuggling as a key method used to launder criminal proceeds and highlighted how drug traffickers were smuggling U.S. dollars obtained from illegal U.S. drug sales across the border into Mexico and then using various means to arrange for their deposit into a U.S. bank.<sup>604</sup> In 2006, the U.S. Financial Crimes Enforcement Network (FinCEN) issued an advisory to U.S. financial institutions warning them

<sup>597</sup> Id. at BOG-SR-001405. [Sealed Exhibit.]

<sup>598</sup> See 11/2006 HBUS presentation, "Banknotes Trading A Global Reach Organizational Chart as of November 2006," OCC-PSI-00000501-512.

<sup>599</sup> 1/12/2010 memorandum from the Federal Reserve, "US Department of Justice Investigation of HSBC Bank USA NA's ('HSBC Bank USA' Bank Note Business (Revised)," at BOG-SR-001405. [Sealed Exhibit.]

<sup>600</sup> Id.

<sup>601</sup> Id.

<sup>602</sup> Id.

<sup>603</sup> See Section 371 of the USA Patriot Act, P.L. 107-56, codified at 31 U.S.C. §5332 (outlawing the smuggling or attempted smuggling of over \$10,000 in currency or monetary instruments into or out of the United States, with the specific intent to evade U.S. currency reporting requirements).

<sup>604</sup> See Dec. 2005 "U.S. Money Laundering Threat Assessment," issued by the Money Laundering Threat Assessment Working Group, which included the U.S. Departments of Treasury, Justice, and Homeland Security, Federal Reserve, and U.S. Postal Service, Chapter 5 on "Bulk Cash Smuggling" ("Upon leaving the country, cash may stay in Mexico, continue on to a number of other countries, or make a U-turn and head back into the United States as a deposit by a bank or casa de cambio.").

in particular about money laundering associated with bulk cash shipments from Mexican casas de cambio.<sup>605</sup>

As of 2010, 29 HSBC affiliates had banknotes accounts with HBUS.<sup>606</sup> Some of those affiliates operated in high risk countries plagued by drug trafficking, corruption, money laundering, or other criminal enterprises, including Angola, Bangladesh, Colombia, Democratic Republic of Congo, Haiti, Mexico, Panama, Paraguay, Saudi Arabia, and Ukraine. HBUS did not distinguish, however, between high and low risk affiliates with banknotes accounts.<sup>607</sup>

## (2) HBMX U.S. Dollar Sales to HBUS

For a three-year period, from mid-2006 until mid-2009, HBUS accepted more than \$15 billion in physical U.S. dollars from other HSBC affiliates, but failed to conduct any AML monitoring of the bulk cash transactions.<sup>608</sup> HBUS had performed AML monitoring both prior to and following that time period. HBUS personnel have been unable to explain why all AML monitoring of its banknotes accounts ceased during that period and then resumed later, but the OCC has noted that the monitoring ceased when a formal AML oversight agreement applicable to HBUS expired, and resumed when an OCC AML examination of the banknotes operations was launched in July 2009.<sup>609</sup> The absence of AML monitoring meant that HBUS did not track for AML purposes its growing dollar traffic with HBMX, which reached \$3 billion in 2007, and then jumped another 25% in 2008 to \$4 billion.<sup>610</sup>

In February 2008, Mexican regulators held a private meeting with HBMX CEO Paul Thurston and informed him that HBMX was repatriating more U.S. dollars to the United States than any other Mexican bank – more than each of the four largest Mexican banks, all of which were larger than HBMX.<sup>611</sup> The CNBV also informed Mr. Thurston that the Mexican Financial Intelligence Unit (FIU) was very

<sup>605</sup> 4/28/2006 “FinCEN Guidance to Financial Institutions on the Repatriation of Currency Smuggled into Mexico from the U.S.,” No. FIN-2006-A003.

<sup>606</sup> See 9/13/2010 OCC Supervisory Letter HSBC-2010-22, OCC-PSI-00864335-365, at 342. [Sealed Exhibit.]

<sup>607</sup> Id. at OCC-PSI-00864336.

<sup>608</sup> Id. at 336.

<sup>609</sup> See id. at 360. When asked why HBUS stopped monitoring its affiliates’ banknotes activity, HBUS personnel offered conflicting reasons. Daniel Jack, in charge of HBUS compliance for banknotes, thought that his supervisor, Alan Ketley, had approved the decision to stop monitoring affiliates, but Alan Ketley did not recall the decision. Neither did their superior, Teresa Pesce. David Bagley called the decision to stop monitoring banknotes for affiliates “inexplicable.” Subcommittee interviews of Daniel Jack (3/13/2012), Alan Ketley (2/16/2012), Teresa Pesce (3/30/2012) and David Bagley (4/12/2012).

<sup>610</sup> Id.; 6/29/2009 OCC notes of telephone conversations, prepared by OCC AML Examiner Joseph Boss, OCC-PSI-00928760.

<sup>611</sup> See 2/18/2008 draft report entitled, “Internal Control, HBC Mexico, S.A.,” prepared by CNBV, HSBC OCC 8966021-026, at 5.

concerned about the “high level of ML [money laundering] risk” involved.<sup>612</sup> The FIU indicated that in the “majority of the most relevant ML cases” they had investigated in 2007, “many transactions were carried out through” HBMX.<sup>613</sup>

In November 2008, the CNBV and FIU held a second private meeting, not only with the HBMX CEO, then Luis Pena, but also with the HSBC CEO of Latin America, Emilson Alonso, and the CEO of the HSBC Group, Michael Geoghegan.<sup>614</sup> Again, the regulators expressed their alarm at the volume of U.S. dollars that HBMX was sending to the United States and described law enforcement concerns about the extent to which those dollars may be the proceeds of illegal drug trafficking in the United States. A November email from the HSBC Group Compliance Deputy Head summarizing the meeting stated that, between January and September 2008, HBMX had repatriated \$3 billion to the United States, which represented 36% of the market volume and double what the biggest bank in Mexico, Banamax, had repatriated, even though HBMX was only the fifth largest bank in the country.<sup>615</sup> According to an internal OCC document, the Department of Homeland Security’s Immigration and Customs Enforcement (ICE) division conveyed that, within Mexico, HBMX “led the market in cash repatriation in 2007 and 2008,” with “\$3.2 billion repatriated in 2007 and \$4.2 billion repatriated in 2008.”<sup>616</sup>

A quick analysis undertaken by HBMX immediately after the November meeting found that while HBMX was “very good at buying/acquiring dollars,” it did “not seem to sell them and hence our very high repatriation figures.”<sup>617</sup> The analysis also determined that “80% of our dollars come from money exchange business at branches.”<sup>618</sup> It noted further that “there is no limit on the amount of dollars that c[u]stomers can convert to pesos,” and that with respect to non-customers, HBMX branches would “convert up to 3000 dollars, and do not require any KYC.”<sup>619</sup> HSBC Group Compliance head David Bagley responded: “The practice of changing USD in the branches pres[u]mably with little or no ID for non customers is in breach of

<sup>612</sup> Id.

<sup>613</sup> Id. at 6. Examples of these cases included Zhenly Ye Gon, Casa de Cambio Puebla, and Sigue Corporation.

<sup>614</sup> See 11/27/2008 email from HSBC Warren Leaming to HSBC David Bagley and Richard Bennett, “Mexico,” HSBC OCC 8875605-607.

<sup>615</sup> 11/27/2008 email from HSBC Warren Leaming to HSBC David Bagley and Richard Bennett, “Mexico,” HSBC OCC 8875605-607, at 606.

<sup>616</sup> 6/29/2009 OCC notes of telephone conversations, prepared by OCC AML Examiner Joseph Boss, OCC-PSI-00928760.

<sup>617</sup> 11/27/2008 email from HSBC Warren Leaming to HSBC David Bagley and Richard Bennett, “Mexico,” HSBC OCC 8875605-607, at 606.

<sup>618</sup> Id.

<sup>619</sup> Id.

Group policy. When looking at our USD exposure how can this have been missed.”<sup>620</sup>

At HBUS, an undated analysis was conducted of its banknotes traffic with Mexican financial institutions over a three-month period, from November 2006 to February 2007.<sup>621</sup> The analysis disclosed that HBUS was doing far more business with HBMX than any other Mexican financial institution. It showed that during the three-month period:

- HBUS had purchased about \$470 million in U.S. dollars from Banco Mercantil Del Norte, a major Mexican bank, while selling it only about \$22 million in U.S. dollars.
- HBUS had purchased about \$281 million in U.S. dollars from BBVA Bancomer, another major Mexican bank, while selling it only about \$5 million.
- HBUS had purchased about \$196 million in U.S. dollars from Case de Cambio Puebla, and \$194 million from Consultoria International, without selling either any U.S. dollars.
- During the same period, HBUS had purchased about \$742 million in U.S. dollars from HBMX, while selling it only a little more than \$1.3 million.

These figures indicate that HBMX was, by far, HBUS’ largest banknotes customer in Mexico.

In July 2009, the OCC initiated an AML examination of HBUS’ global banknotes operations, and soon discovered that the bank was not monitoring the banknotes activities of its affiliates.<sup>622</sup> That same month, HBUS resumed monitoring its banknote accounts.<sup>623</sup> In September, the OCC requested documentation related to banknotes accounts for 25 Latin American financial institutions, including ten in Mexico. In November 2009, the examination team added examiners from the Federal Reserve. Additional requests for information were made, including with respect to HSBC affiliates with banknotes accounts,

<sup>620</sup> 11/27/2008 email from HSBC David Bagley to HSBD Warren Leaming, copy to Richard Bennett, “Mexico,” HSBC OCC 8875605.

<sup>621</sup> See undated “HBUS Banknotes NY – USD Bought from or Sold to Customers in Mexico: 3-Month Period (Nov-06 to Feb-07),” prepared by HBUS, OCC-PSI-00151506. See also undated “Banknotes-NY Selected Customers’ Activity Alerts & Traders’ Explanations for USD Purchases & Sales from 2005-2009,” prepared by HNAH, OCC-PSI-00005890-904.

<sup>622</sup> See 2/6/2010 email from HBUS Janet Burak to HBUS Brendan McDonagh, “Expanded ‘Banknotes Exam,’” OCC-PSI-00787479 (summarizing the banknotes examination effort). See also Subcommittee interview of Joseph Boss (1/30/2012).

<sup>623</sup> See 9/13/2010 OCC Supervisory Letter HSBC-2010-22, OCC-PSI-00864335-365, at 360. [Sealed Exhibit.]



HBMX, Mexican casas de cambio, and HBMX's U.S. dollar accounts in the Cayman Islands.

In August 2009, the OCC summarized some of the information in an internal memorandum.<sup>624</sup> According to the OCC, due to transaction costs, banknotes transactions at HBUS typically occurred only about once per month and involved large shipments.<sup>625</sup> In addition, transaction volumes often fluctuated on a seasonal basis, increasing during holidays or tourist seasons.<sup>626</sup> According to the OCC, HBUS said that it conducted AML monitoring on a monthly basis, examining banknotes transactions by customer and inquiring when significant changes in the volume of U.S. dollar sales or purchases took place.<sup>627</sup>

When the OCC conducted tests on the 2009 HBUS banknotes data, however, it determined that the volume data was not always accurate, and HBUS did not keep records of its reviews or actions:

"When volumes changed significantly, the bank did not seem to be aware of these changes, and it does not appear that the bank took any action as a result. For example, even though transactions volumes for customers in Mexico increased significantly from the first 6 months of 2008, over the first 6 months of 2009, there was no documentation in the files that the bank noted the change or took any action. ... Bank employees ... assured us that adequate monitoring takes place within the business line and Compliance. However, we were unable to find anything in the files that this was the case. They also cautioned that too much documentation results in increased legal risk. We explained to the bank that written documentation is necessary, for institutional memory, and to ensure that controls are exercised. We noted the bank's appetite for risk, as well as the risk inherent in the Banknotes business. The business line seemed to resist this message, but Compliance staff seemed to eventually grasp the importance of better documentation."<sup>628</sup>

As the data confirmed that HBMX was the single largest supplier of U.S. dollars to HBUS, transferring billions of dollars that far outstripped the volumes being supplied by larger Mexican banks and other HSBC affiliates, Mexican and U.S. law enforcement and regulatory authorities continued to express concern that HBMX's bulk cash shipments could reach that volume only if they included illegal

<sup>624</sup> See 8/13/2009 OCC memorandum to OCC AML Examiners from the OCC Compliance Risk Analysis Division, "HSBC Global Banknotes, Compliance RAD assistance," OCC-PSI-00846642. [Sealed Exhibit.]

<sup>625</sup> Id. at 4.

<sup>626</sup> Id.

<sup>627</sup> Id.

<sup>628</sup> Id. at 4-5.

drug proceeds. In a January 2010 meeting, U.S. law enforcement and regulators also expressed concern that the problem extended beyond Mexico:

“The bulk cash receipts by HSBC’s Bank Note Business from certain correspondent accounts based in Central and South America exceed reasonably expected volumes of USDs that should be within those countries from tourism, foreign business, etc.”<sup>629</sup>

### (3) Remedial Action

In response to the concerns expressed by regulators and law enforcement, HBMX took a number of steps to gain a better understanding and control of its U.S. dollar transactions. The first set of actions, in February 2008, focused on gaining better information. HBMX announced a new policy, effective immediately, to deem all customers who deposited more than \$100,000 in a month as SCC clients subject to enhanced due diligence. HBMX identified 312 customers that met that criteria and subjected them to a KYC review.<sup>630</sup> HBMX also undertook a review of its branches to identify the nature and volume of their U.S. dollar transactions,<sup>631</sup> and a review of its money service business clients to determine whether each relationship should continue.<sup>632</sup> Still another action HBMX took was to change its account monitoring criteria to increase scrutiny of U.S. dollar deposits by customers.<sup>633</sup>

In November 2008, after another meeting with regulators critical of its U.S. dollar transactions, HBMX went further. It ordered its branches to stop providing physical U.S. dollars to customers and non-customers alike, other than through ATMs at airports.<sup>634</sup> It also prohibited

<sup>629</sup> 1/11/2010 meeting memorandum, prepared by the Federal Reserve Bank of Chicago, “DOJ Concerns with HSBC Bank Notes Activities,” BOG-SR-001402-1409, at 402 [Sealed Exhibit.]

<sup>630</sup> See undated “Actions taken since 18FEB,” prepared by HBMX, HSBC OCC 8875040-041 (describing actions taken after a Feb. 18, 2008 meeting with the CNBV); 3/3/2008 “Internal Control, HSBC Mexico SA,” prepared by HBMX, HSBC OCC 8966027-038. But see 7/28/2008 email from HBMX Luis Alvarez to HSBC John Root and HBMX Ramon Garcia, “Major Issues Outstanding,” HSBC OCC 8873598 (“In order to mitigate risk in HBMX, 100K process was implemented (customers which make USD cash deposits exceeding 100k within a one-month period). It has been identified that 974 customers made cash deposits for a total amount of USD308 Million from Jan to May. These customers are classified in our monitoring systems as high-risk customers and an enhanced KYC must be performed for them. If any customers do not meet requirements, accounts are closed.”).

<sup>631</sup> See, e.g., undated “Rectification Programme – 12 major projects in 6 categories,” prepared by HBMX, HSBC OCC 8875046 (listing as item 5, on “USD Banknotes”: “Review of USD intensive customers” and “Analysis of transaction patterns through branches”).

<sup>632</sup> 7/28/2008 email from HBMX Luis Alvarez to HSBC John Root and HBMX Ramon Garcia, “Major Issues Outstanding,” HSBC OCC 8873598.

<sup>633</sup> Undated “Actions taken since 18FEB,” prepared by HBMX, HSBC OCC 8875040-041 (describing actions taken after a Feb. 18, 2008 meeting with the CNBV).

<sup>634</sup> See 11/27/2008 email from HBMX Luis Pena to HBMX Emilson Alonso, copy to HSBC Michael Geoghegan, “Money Laundering,” HSBC OCC 8874849.

branches from accepting U.S. dollar cash deposits from customers.<sup>635</sup> In addition, HBMX stopped opening new U.S. dollar accounts at its Cayman branch, and prohibiting the acceptance of new cash deposits for existing Cayman accounts.<sup>636</sup> All of these actions led to a steep drop in the number and volume of HBMX U.S. dollar transactions.

As HBMX cut back dramatically on its U.S. dollar business beginning in early 2009, OCC AML examiners found that HBUS appeared to be increasing its U.S. dollar transactions with Mexican clients, including some of the high risk casas de cambio that could no longer engage in the same volume of U.S. dollars with HBMX.<sup>637</sup> HSBC Group Compliance knew about HBUS' Mexican casa de cambio clients. Rather than press HBUS to close the accounts, however, HSBC Group Compliance head David Bagley merely observed to a colleague in January 2009: "I am surprised that HBUS still have cambio clients."<sup>638</sup>

A year later, in June 2010, HBUS decided to exit the U.S. banknotes business. It closed the Global Banknotes offices in New York, London, Hong Kong, and Singapore, and later sold portions of the banknotes business to other banks.<sup>639</sup> HBUS also declined to renew its contract to operate U.S. currency vaults for the Federal Reserve Bank of New York when that contract expired in 2010. In September 2010, the OCC issued a supervisory letter identifying multiple AML deficiencies at HBUS, including with respect to its banknotes business, and followed with a cease and desist order in October.

## F. Analysis

Over the years, HBUS maintained correspondent accounts for at least 80 HSBC affiliates and banknotes accounts for at least 29 HSBC affiliates, which accounted for a large portion of its U.S. dollar activities. In 2009, for example, HSBC determined that "HSBC Group affiliates clear[ed] virtually all USD [U.S. dollar] payments through accounts held at HBUS, representing 63% of all USD payments processed by HBUS."<sup>640</sup> HSBC also calculated that, over an eight-year period, its

<sup>635</sup> Id.

<sup>636</sup> 11/27/2008 email from HSBC Warren Leaming to HSBC David Bagley and Richard Bennett, "Mexico," HSBC OCC 8875605-607.

<sup>637</sup> See, e.g., 9/1/2009 OCC memorandum to the Files, "Washington Meeting," OCC-PSI-01416833 ("[O]nce HSBC Mexico ceased its operations, HBUS began significant volume of Banknote activity directly with some of HSBC Mexico's former Banknote clientele."). [Sealed Exhibit.]

<sup>638</sup> 1/27/2009 email from HSBC David Bagley to HSBC Susan Wright and Warren Leaming, "Press Release," HSBC OCC 8873485.

<sup>639</sup> Id. In 2010, HSBC Holdings plc sold its U.S. wholesale banknotes business in Asia to United Overseas Bank Limited (UOB) for \$11 million, and in 2011, sold its European banknotes business to HSBC Bank plc. It recorded total closure costs of \$14 million during 2010. Id.

<sup>640</sup> See 9/9/2009 chart entitled, "HSBC Profile," included in "HSBC OFAC Compliance Program," a presentation prepared by HSBC and provided to the OCC, at HSBC OCC 8874197.

U.S. dollar clearing business had increased over 200%, from processing an average daily amount of \$185 billion in 2001, to \$377 billion in 2009.<sup>641</sup> HBUS functioned as the U.S. nexus for the entire HSBC global network of financial institutions. Some of those institutions used their access to the U.S. financial system as a selling point to attract clients.<sup>642</sup> Not all of those affiliates operated in high risk jurisdictions like Mexico; not all had high risk clients like casas de cambio; not all had high risk products like U.S. dollar Cayman accounts; and not all had weak AML controls. But some HSBC affiliates operated under those circumstances, and HBMX provides a case history of the money laundering risks that followed. HBMX illustrates how the U.S. affiliate of a global bank can better protect itself by conducting careful due diligence of fellow affiliates, as already required by law, identifying higher risk institutions, and understanding their high risk clients, high risk products, AML controls, and money laundering vulnerabilities. HBMX also illustrates the need for ongoing, effective account monitoring to detect, prevent, and report suspicious activity. Effective monitoring and SAR reporting require adequate resources and personnel. Still another lesson is that AML personnel at the parent and affiliates of a global bank should consider all legal avenues for systematically sharing information with each other about suspicious clients and transactions in order to combat misuse of their network by drug traffickers, organized crime, and other wrongdoers.

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<sup>641</sup> Id. at "USD Payment Statistics – Fact Sheet," HSBC OCC 8874211.

<sup>642</sup> Subcommittee interview of Michael Geoghegan (5/42/2012).

#### **IV. HSBC AFFILIATES: CIRCUMVENTING OFAC PROHIBITIONS**

The United States prohibits doing business with certain persons and entities, including terrorists, persons engaged in nuclear proliferation, drug kingpins, and persons associated with rogue jurisdictions such as Iran, North Korea, and Sudan. To implement the law, the U.S. Treasury Department's Office of Foreign Assets Control (OFAC) has developed a list of those prohibited persons and countries which banks use to create an "OFAC filter" to identify and halt potentially prohibited transactions. Transactions stopped by an OFAC filter typically undergo an individualized review to see if the transaction can proceed.

Foreign banks that engage in U.S. dollar transactions typically execute them through the account of a bank in the United States, subject to the U.S. bank's OFAC filter. While most processing takes less than 24 hours, transactions stopped by the OFAC filter for further review may undergo substantial processing delays and, in some cases, payments may be blocked and held for years. Because of the additional time and expense involved when transactions are subjected to review, some foreign banks have developed a variety of tactics to avoid the OFAC filter. Common tactics included intentionally stripping information from the transaction documentation to conceal the participation of a prohibited country or person, or using "cover payments." In the context of Iranian transactions, cover payments are transfers between correspondent banks in non-sanctioned jurisdictions which lack underlying payment details, including information about a party that is a prohibited country or person. In the case of Iranian U.S. dollar transactions, some banks used one or both of these practices when conducting so-called "U-turn" transactions, a type of transaction that was allowed under OFAC regulations prior to November 2008, but because the transactions referenced Iran, routinely triggered the OFAC filter and required an individualized review which delayed the transaction's processing. In recent years, U.S. law enforcement has penalized some international banks that used willfully deceptive tactics to circumvent the OFAC filter and process prohibited transactions.

The Subcommittee conducted a review of issues related to the sending of OFAC sensitive transactions through HBUS' correspondent accounts from 2000 to 2010, by HSBC affiliates. The evidence indicates that, for years, some HSBC affiliates sending OFAC sensitive transactions involving Iran through their U.S. dollar correspondent accounts at HBUS took steps to conceal them, including by deleting references to Iran from the payment instructions or by characterizing the transaction as a transfer between banks in permitted jurisdictions without disclosing any Iranian connection. More specifically, from at least 2001

to 2007, two HSBC affiliates, HSBC Europe (HBEU) and later HSBC Middle East (HBME), repeatedly conducted U-turn transactions involving Iran through HBUS, many of which were not disclosed to the bank, even though they knew HBUS required full transparency to process U-turns. To ensure HBUS cleared the transactions without delay, HBEU routinely altered transaction documentation to delete any reference to Iran that might trigger the OFAC filter at HBUS and also typically characterized the transaction as a transfer between banks in permitted jurisdictions. The aim of the affiliates' efforts appeared to be to ensure the Iranian transactions utilized HBUS' automated processing procedures and avoided any human intervention or manual review, a process known as straight through processing or STP. Internal bank documents also indicate that the affiliates viewed the U-turns they sent through HBUS' accounts as permitted by OFAC rather than prohibited transactions under U.S. law, but their failure to provide full transparency prevented any individualized review by HBUS to confirm their legality.

Internal bank documents show that HSBC Group Compliance knew of HBUS' insistence on full transparency for U-turns and the practice of HSBC affiliates to conceal the Iranian transactions sent through their U.S. dollar correspondent accounts at HBUS. HSBC Group Compliance, as well as other senior HSBC Group executives, allowed the HSBC affiliates to continue to engage in these practices, which even some within the bank viewed as deceptive, for more than five years without disclosing the extent of the activity to HBUS. The bank documents show that, from 2000 to 2005, the practice of altering U-turn transaction documentation was repeatedly brought to the attention of HSBC Group Compliance, including by HBEU personnel who objected to participating in the alteration of documents and twice announced deadlines to end the activity. Despite receiving this information, HSBC Group Compliance did not stop HSBC affiliates from sending concealed Iranian transactions through HBUS' accounts until the bank decided to exit Iran altogether in 2007.

At the same time, while some at HBUS claimed not to have known they were processing undisclosed Iranian transactions from HSBC affiliates, internal documents show key senior HBUS officials were informed as early as 2001. In addition, on several occasions, HBUS' OFAC filter stopped Iranian transactions that HBUS had indicated should be disclosed by HSBC affiliates, but were not. Despite the evidence of what was taking place, HBUS failed for years to demand a full accounting of what HSBC affiliates were doing. While HBUS insisted, when asked, that HSBC affiliates provide fully transparent transaction information, when it obtained evidence that some affiliates were acting to circumvent the OFAC filter, HBUS failed to take decisive action to confront those affiliates, stop the conduct, and ensure all Iranian U-turns were subjected to individualized reviews to gauge whether they complied with the law.

In addition to Iranian transactions, HBUS documents indicate that, from at least 2002 to 2007, some HSBC affiliates also sent potentially prohibited transactions through HBUS involving Burma, Cuba, North Korea, or Sudan, although none of the affiliates employed the same type of systematic effort used for transactions involving Iran. In recent years, HBUS' OFAC compliance program as a whole has also displayed AML deficiencies.

In 2010, HBUS hired an outside auditor, Deloitte LLP, to identify and examine the OFAC sensitive transactions involving Iran and other prohibited countries or persons that went through the bank.<sup>643</sup> That review, which is ongoing and has yet to review all relevant transactions, has so far identified, over a seven-year period from 2001 to 2007, more than 28,000 OFAC sensitive transactions sent through HBUS involving a total of \$19.7 billion. Of those 28,000 transactions, more than 25,000 totaling more than \$19.4 billion involved Iran, while 3,000 involved other prohibited countries or persons. The Deloitte review characterized 2,584 of those transactions, involving assets in excess of \$367 million, 79 of which involved Iran, as "Transactions of Interest" requiring additional analysis to determine whether violations of U.S. law occurred.<sup>644</sup> HBUS is currently in the process of analyzing those transactions, which could lead to financial penalties if it is found to have violated OFAC regulations.

Finally, another issue involves actions taken by some HSBC Latin American affiliates, with the approval of HSBC Group Compliance, to send non-U.S. dollar payment messages through a U.S. server whose OFAC filter was not turned on to screen them for terrorists, drug kingpins, or other prohibited persons. HSBC Group Compliance allowed those payment messages to move through the United States and utilize U.S. facilities while bypassing the OFAC filter, despite HBUS concerns that such messaging traffic might require OFAC screening to block transfers involving terrorism, drug trafficking, or other wrongdoing. The transactions were later screened by HSBC Group's WOLF filter.

#### **A. Background on OFAC Prohibitions**

**OFAC.** The Office of Foreign Assets Control (OFAC) within the U.S. Department of Treasury administers and enforces economic and trade sanctions stemming from U.S. foreign policy and national security goals, and other threats to the foreign policy, national security, or economy of the United States.<sup>645</sup> The office was formally established in

<sup>643</sup> See Deloitte Review of OFAC transactions, "Results of the Transactions Review – UK Gateway, March 29, 2012," HSBC-PSI-PROD-0197919-989, at 930.

<sup>644</sup> Id.

<sup>645</sup> See U.S. Department of Treasury Office of Foreign Assets Control (OFAC), <http://www.treasury.gov/about/organizational-structure/offices/Pages/Office-of-Foreign-Assets-Control.aspx>.

December 1950, when President Truman blocked all Chinese and North Korean assets subject to U.S. jurisdiction.<sup>646</sup> Its programs seek to prohibit U.S. persons and entities from engaging in trade or financial transactions with terrorists, persons engaged in activities related to the proliferation of weapons of mass destruction, international narcotics traffickers, and rogue jurisdictions.

OFAC's regulatory authority is exercised under Presidential national emergency powers and laws enacted by the U.S. Congress to impose controls on transactions and authorize the freezing of assets under U.S. jurisdiction. According to OFAC, "[m]any of the U.S. sanctions are based on United Nations and other international mandates, are multilateral in scope, and involve close cooperation with allied governments."<sup>647</sup> The freezing of assets "immediately imposes an across-the-board prohibition against transfers or dealings of any kind with regard to the property," and the owner of the asset must contact OFAC directly to request the release of a frozen asset. OFAC prohibitions support U.S. and international efforts to combat terrorism, nuclear proliferation, drug trafficking, and other wrongdoing.

OFAC administers both comprehensive and selective sanctions programs. The comprehensive U.S. programs apply to persons and entities within a designated jurisdiction and have applied to Burma (Myanmar), Cuba, Iran, Sudan, and Syria. The non-comprehensive programs target specific individuals and entities rather than impose broad prohibitions involving an entire country. These programs have applied at times to persons and entities associated with Iraq, Libya, North Korea, Somalia, and Zimbabwe. To carry out U.S. sanctions programs, OFAC has developed a list of Specially Designated Nationals and Blocked Persons (SDN). The SDN designation covers both individuals and entities in which SDN persons have a direct or indirect ownership interest of 50% or more. The SDN designation applies to covered entities whether or not the entity is named on the SDN list.<sup>648</sup> U.S. persons are prohibited from dealing with persons and entities on the SDN list, and all SDN assets in the United States are supposed to be blocked. OFAC also has authority to grant general and specific "licenses," which authorize exceptions for certain categories of transactions, such as those related to humanitarian efforts.<sup>649</sup>

<sup>646</sup> Id. OFAC is the successor to the Office of Foreign Funds Control (the "FFC") that was established at the beginning of World War II in 1940. However, the Treasury Department administered sanctions as far back as the War of 1812 when sanctions were imposed against Great Britain. Id.

<sup>647</sup> Id.

<sup>648</sup> See OFAC website, FAQ #10: [http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/ques\\_index.aspx](http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/ques_index.aspx).

<sup>649</sup> Id.



OFAC regulations apply to all U.S. persons, both citizens and permanent resident aliens, regardless of where they are located, as well as all persons and entities within the United States, and all U.S. incorporated entities and their foreign branches.<sup>650</sup> Fines for violating U.S. sanction laws and OFAC regulations can be substantial. Criminal penalties can result in fines ranging from \$50,000 to \$10 million and imprisonment for 10 to 30 years for willful violations. Civil penalties in various matters range from \$250,000 or twice the amount of each underlying transaction to \$1,075,000 for each violation.<sup>651</sup>

**Iran and U-turn Transactions.** For more than thirty years, dating back to 1979, the United States has applied sanctions programs to Iran, enforced by OFAC.<sup>652</sup> These programs have generally prohibited U.S. persons from engaging in transactions with anyone associated with Iran, and the OFAC filter has stopped any financial transaction including an Iranian reference.

Between 1995 and November 10, 2008, however, OFAC regulations also included an exception to the prohibition on Iranian transactions commonly referred to as “U-turns.” U-turn transactions were authorized by OFAC under regulations issued in 1995. In that year, President Clinton declared that Iran was an international threat for its attempt to obtain a nuclear weapon as well as its role in undermining ongoing peace talks in the Middle East. As such, U.S. financial institutions were generally barred by OFAC from processing transactions involving Iran. In their place, OFAC allowed only those Iran-related transactions that began and ended in non-Iranian foreign banks. According to Treasury:

“This is commonly referred to as the ‘U-turn’ authorization. It is so termed because it is initiated offshore as a dollar-denominated transaction by order of a foreign bank’s customer; it then becomes a transfer from a correspondent account held by a domestic bank for the foreign bank to a correspondent account held by a domestic bank for another foreign bank; and it ends up offshore as a transfer

<sup>650</sup> See OFAC website, FAQ #11: <http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/answer.aspx#10>

<sup>651</sup> See U.S. Department of Treasury Office of Foreign Assets Control (OFAC), <http://www.treasury.gov/about/organizational-structure/offices/Pages/Office-of-Foreign-Assets-Control.aspx>.

<sup>652</sup> See 31 C.F.R. Part 535, Iranian Assets Control Regulations, and 31 C.F.R. Part 560, Iranian Transactions Regulations, which together comprise the Iranian sanctions program. Initial Iranian sanctions regulations, now detailed in Part 535, were created on November 14, 1979, after U.S. diplomats were taken hostage in Tehran, and President Carter blocked assets located in the United States belonging to the Government of Iran. On October 29, 1987, following Iran’s expressions of support for international terrorism and aggressive actions against non-hostile shipping in the Persian Gulf, President Reagan issued Executive Order 12613, the predecessor to Part 560. From 1995 to 1997, President Clinton issued three additional Executive Orders, numbered 12957, 12959, and 13059, which culminated in a prohibition of nearly all trade and investment activities with Iran by U.S. persons, regardless of location.

to a dollar-denominated account of the second foreign bank's customer."<sup>653</sup>

In essence, the new regulations only allowed U.S. financial institutions to clear U.S. dollar transactions involving non-Iranian intermediaries, even if they involved Iranian clients. This restriction meant transactions involving Iran could be processed only if the beginning and ending points were non-Iranian foreign banks. The purpose of U-turn transactions was to allow U.S. dollar-denominated transactions to continue throughout the world – benefitting both U.S. commerce and the value of the dollar – but to prevent U.S. citizens and institutions from doing business with Iran. This goal was accomplished by ensuring that the only point such transactions touched the United States was in clearing them for foreign banks.

The U-turn exception was widely used to carry out U.S. dollar Iranian transactions in the United States for many years. In November 2008, the exception was revoked, and it was no longer legal under OFAC regulations to clear Iran-linked transactions even for foreign banks, although U.S. banks were still permitted to handle Iranian funds in limited circumstances, including transactions supporting humanitarian relief.<sup>654</sup> U.S. persons were explicitly prohibited, however, from engaging in any transaction or dealing in any property or property interest with any Iranian bank designated under the Nonproliferation of Weapons of Mass Destruction or Specially Designated Global Terrorist programs.<sup>655</sup>

The U-turn exception for Iran in OFAC regulations until 2008 does not appear in any other OFAC regulation, and so does not affect transactions involving any other prohibited country or person.

**Prosecutions for OFAC Violations.** In recent years, a number of large, international banks have been prosecuted for systematically violating OFAC prohibitions. In most cases, the violations involved the practice of stripping information from wire transfer documentation to hide the participation of a prohibited person or country, and executing the prohibited transaction through a U.S. dollar account at a U.S. financial institution. For example, in December 2009, Credit Suisse was fined \$536 million by the Department of Justice for altering wire transfer documentation from 1995 to 2006, in transactions involving Burma, Cuba, Iran, and Libya. That same month Lloyd's Bank was fined \$217

<sup>653</sup> See Treasury website, [http://www.treasury.gov/resource-center/sanctions/Documents/fr73\\_66541.pdf](http://www.treasury.gov/resource-center/sanctions/Documents/fr73_66541.pdf); OFAC website, <http://www.treasury.gov/about/organizational-structure/offices/Pages/Office-of-Foreign-Assets-Control.aspx>, at 2.

<sup>654</sup> See OFAC website, <http://www.treasury.gov/about/organizational-structure/offices/Pages/Office-of-Foreign-Assets-Control.aspx>, at 2.

<sup>655</sup> *Id.* at 2.

million for stripping information from wire transactions over a ten-year period, from the mid 1990s through September 2007. In May 2010, ABN Amro was fined \$500 million for removing information from wire transfers involving OFAC sanctioned countries between 1995 and 2005.

Most recently, on June 12, 2012, the U.S. Justice Department and New York County District Attorney's Office entered into a deferred prosecution agreement with ING Bank N.V. and imposed the largest fine ever levied against a bank for OFAC violations.<sup>656</sup> For processing more than \$2 billion in transactions on behalf of Cuban, Iranian, and other prohibited persons, ING Bank agreed to a criminal forfeiture of \$619 million. The Treasury Department's press release revealed that ING Bank had "intentionally manipulated financial and trade transactions to remove references to Iran, Cuba, and other sanctioned countries and entities."<sup>657</sup> It noted that ING Bank's methods included not referencing a payment's origin, utilizing "misleading" payment messages, and using shell companies. According to court filings, between the early 1990s and 2007, ING Bank processed more than 20,000 transactions in violation of OFAC prohibitions, "with the knowledge, approval and encouragement of senior corporate managers and legal and compliance departments."<sup>658</sup>

A summary of recent prosecutions and legal actions related to OFAC violations follows.

#### Recent Prosecutions and Legal Actions Related to OFAC Violations

Bank	Date	Fine	Link	Brief Summary
ING Bank N.V.	6/12/2012	\$619 million	<ul style="list-style-type: none"> <li>• <a href="http://www.treasury.gov/press-center/press-releases/Pages/tg1612.aspx">DOI Press Release (http://www.treasury.gov/press-center/press-releases/Pages/tg1612.aspx)</a></li> </ul>	The Department of Justice and the New York County District Attorney's Office entered into simultaneous deferred prosecution agreements with ING Bank relating to 20,000 transactions totaling \$1.6 billion processed through the U.S. financial system on behalf of Cuban and Iranian entities from the early 1990s through 2007.

<sup>656</sup> See, e.g. *United States v. Ing Bank, N.V.*, Case No. 1:12cr136 (USDC DDC), Information (6/12/2012) and Deferred Prosecution Agreement (6/12/2012).

<sup>657</sup> 6/12/2012 "ING Bank N.V. Agrees to Forfeit \$619 Million For Illegal Transactions With Cuban and Iranian Entities," Treasury press release, [www.treasury.gov/press-center/press-releases/Pages/tg1612.aspx](http://www.treasury.gov/press-center/press-releases/Pages/tg1612.aspx).

<sup>658</sup> *Id.*

Barclays Bank	8/18/2010	\$298 million	<ul style="list-style-type: none"> <li>• <u>DOJ Press Release</u> (<a href="http://www.justice.gov/opa/pr/2010/August/10-crm-933.html">http://www.justice.gov/opa/pr/2010/August/10-crm-933.html</a>)</li> <li>• <u>Wall Street Journal, Probe Circles Globe to Find Dirty Money</u> (<a href="http://online.wsj.com/article/SB10001424052748703431604575468094090700862.html">http://online.wsj.com/article/SB10001424052748703431604575468094090700862.html</a>)</li> </ul>	The Department of Justice and the New York County District Attorney's Office entered into deferred prosecution agreements with Barclays Bank for activity relating to transactions illegally conducted for customers in Cuba, Iran, Libya, Sudan, and Burma from the mid-1990s until September 2006.
ABN Amro Bank	5/10/2010	\$500 million	<ul style="list-style-type: none"> <li>• <u>DOJ Press Release</u> (<a href="http://www.justice.gov/opa/pr/2010/May/10-crm-548.html">http://www.justice.gov/opa/pr/2010/May/10-crm-548.html</a>)</li> <li>• <u>Wall Street Journal, RBS, DOJ to End Deferred Prosecution Agreement over ABN Amro</u> (<a href="http://blogs.wsj.com/corruption-currents/2011/12/28/rbs-doj-to-end-deferred-prosecution-agreement-over-abn-amro/">http://blogs.wsj.com/corruption-currents/2011/12/28/rbs-doj-to-end-deferred-prosecution-agreement-over-abn-amro/</a>)</li> </ul>	The Department of Justice entered into a deferred prosecution agreement with ABN Amro Bank for removing information from wire transfers from 1995-2005 for customers in Iran, Libya, the Sudan, Cuba, and other OFAC-listed countries.
Credit Suisse Bank	12/16/2009	\$536 million	<ul style="list-style-type: none"> <li>• <u>DOJ Press Release</u> (<a href="http://www.justice.gov/opa/pr/2009/December/09-ag-1358.html">http://www.justice.gov/opa/pr/2009/December/09-ag-1358.html</a>)</li> <li>• <u>DOJ Statement of Facts</u> (<a href="http://www.justice.gov/criminal/pr/documents/12-16-09-CreditSuisse-factualstatement.pdf">http://www.justice.gov/criminal/pr/documents/12-16-09-CreditSuisse-factualstatement.pdf</a>)</li> </ul>	The Department of Justice entered into a deferred prosecution agreement with Credit Suisse. The fines related to alterations on wire transfers from 1995 to 2006 from Iran, Cuba, Burma, and Libya.
Lloyd's Bank	01/09/2009	\$217 million	<ul style="list-style-type: none"> <li>• <u>DOJ Press Release</u> (<a href="http://www.justice.gov/opa/pr/2009/January/09-crm-023.html">http://www.justice.gov/opa/pr/2009/January/09-crm-023.html</a>)</li> </ul>	The Department of Justice and the New York County District Attorney's Office entered into deferred prosecution agreements with Lloyd's Bank for wire stripping transactions from the mid-1990s through September 2007.
Australia and New Zealand Bank Group Ltd.	8/24/2009	\$5.75 million	<ul style="list-style-type: none"> <li>• <u>Treasury Settlement Statement</u> (<a href="http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Documents/anz...08242009.pdf">http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Documents/anz...08242009.pdf</a>)</li> <li>• <u>Enforcement Documents</u> (<a href="http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Documents/08242009.pdf">http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Documents/08242009.pdf</a>)</li> </ul>	The Treasury Department entered into a settlement with the Australia and New Zealand Bank Group relating to currency exchanges from 2004 to 2006, for transactions processed through U.S. correspondent accounts for customers in Cuba and Sudan.

Prepared by the U.S. Senate Permanent Subcommittee on Investigations

HSBC is currently under investigation by the U.S. Justice Department and several Federal financial regulatory agencies for engaging in similar practices in possible violation of OFAC regulations.<sup>659</sup> In October 2010, an internal Federal Reserve email discussing HSBC's decision to hire an outside auditor to review its records "presumably to find problematic transfers," noted that "HSBC was one of the two major UK banks for Iranian banks during the early 2000s (Lloyds being the other), so we can imagine what will be found."<sup>660</sup>

## **B. Executing OFAC-Sensitive Transactions**

### **(1) Transactions Involving Iran**

#### **(a) Overview**

Documents collected by the Subcommittee do not pinpoint when undisclosed Iranian transactions began moving through HBUS in potential violation of OFAC regulations. HSBC officials were aware of the practice generally as early as 2000, as seen in an email discussion between HSBC Group's Compliance head, then Matthew King, and AML head Susan Wright. Ms. Wright criticized actions taken by a bank client to alter transaction documentation to disguise a wire transfer moving through the United States, but their email exchange does not disclose whether such transactions were already taking place at HBUS.<sup>661</sup> By 2001, they clearly were, as described in an email from HBEU to HBUS.<sup>662</sup>

In 2001, when HSBC Europe (HBEU) raised the issue of processing U-turn transactions through its U.S. account in compliance with U.S. requirements, HBUS personnel made it clear that any such transactions would need to be fully transparent and include all underlying payment details to enable HBUS to evaluate whether they qualified as permissible U-turns. From at least 2001 to 2007, however, despite repeated HBUS requests for full transparency, HBEU and later HSBC Middle East (HBME) sent transactions involving Iran through their U.S. dollar correspondent accounts at HBUS without full disclosure of the transaction details. In some instances, the HSBC affiliate simply stripped the identifying Iranian information from the transaction

<sup>659</sup> See 2/27/2012 HSBC Holdings plc 6-K filing with the Securities and Exchange Commission, item 13, <http://sec.gov/Archives/edgar/data/1089113/000119163812000216/hsba201202276k7.htm>.

<sup>660</sup> 10/07/2010 email from Federal Reserve Stephen Meyer to Federal Reserve Kwayne Jennings, and others, "HSBC OFAC."

<sup>661</sup> See 6/16/2000 email from HSBC Susan Wright to HSBC Matthew King, HSBC OCC 8875191-92.

<sup>662</sup> See 6/28/2001 email from HBEU John Wilkinson to HBUS Denise Reilly and others, "Bank Melli;" HSBC OCC 8876132-133, discussed below.

documentation. In others, the HSBC affiliate also sent the transaction as a transfer between banks in permitted jurisdictions, a tactic sometimes referred to as a “cover payment,” since the bank-to-bank transfer acted as a cover for the underlying transaction.<sup>663</sup> Both methods sought to ensure that a transaction would not be stopped by HBUS’ OFAC filter and delayed for individualized review to determine whether it, in fact, qualified as a permissible U-turn, but would instead benefit from “straight through processing” or STP.

From 2001 until 2005, the two HSBC affiliates frequently discussed processing Iranian U.S. dollar transactions for various Iranian financial institutions and entities through their HBUS correspondent accounts. Numerous emails among HBEU, HBME, HBUS, and HSBC Group discuss whether HBUS would be willing to process Iranian U-turn transactions and, if so, how. At the same time, HSBC Group, HBEU and HBME bankers were pushing to expand contacts with Iran. The Senior Payments Manager in HBUS reported being told in a July 2001 conference call that the HSBC Group, with backing from the Chairman, was seeking to “significantly grow our presence in Iran.”<sup>664</sup> In 2003, an HBME business proposal estimated that processing 700 U.S. dollar payments for Iranian banks per day using U-turn transactions would produce income of \$4 million, while failing to process them would threaten HSBC’s current Iranian business which produced annual bank income of \$2 million.<sup>665</sup> HBME also noted that it already had a “number of existing USD accounts for Iranian banks.”<sup>666</sup>

Even though discussions with HBUS over processing the transactions continued in 2002 and 2003, documentation shows that HBEU had already begun to send U-turn transactions through HBUS without disclosing an Iranian connection for many of them.<sup>667</sup> Some HBUE compliance and payments personnel objected to altering payment instructions in connection with the Iranian transactions, and a key payments official even announced deadlines in January 2004 and September 2004, after which no Iranian payment instructions would be altered, but both deadlines were ignored. HBUS finally approved a

<sup>663</sup> The cover method utilizes the MT202 SWIFT message or payment instruction format, which provides a U.S. bank with the names of the foreign banks acting as the originator or beneficiary of the immediate transfer, but is not required also to provide the underlying origination and beneficiary customer information.

<sup>664</sup> 7/12/2001 email from HBUS Denise Reilly to Douglas Stolberg and others, “Bank Melli,” HSBC OCC 8876128-129. HSBC legal counsel told the Subcommittee that the HSBC affiliates were already doing business with Iran, but they wanted to increase that business by doing it with Bank Melli. Subcommittee meeting with HSBC legal counsel (6/20/12).

<sup>665</sup> 1/2003 memorandum from HBME Rick Pudner to HBUS Denise Reilly, HBEU Malcolm Eastwood, and others, “Business Case-USD Payment From Iranian Banks/Entities,” HSBC OCC 8876490.

<sup>666</sup> Id.

<sup>667</sup> See, e.g., 12/30/2002 email from Protomastro to Carolyn Wind and others, HSBC OCC 8873909.

protocol to process transparent U-turns in December 2004.<sup>668</sup> Even after that protocol was approved, however, HBEU continued to send undisclosed U-turn payments through HBUS using cover payments, failing to provide requested information to its own affiliate.

At HBUS, during the same time period, internal documents show that, as early as 2001, senior HBUS payments, compliance, and business managers were informed that Iranian U.S. dollar payments were being sent by HBEU through HBUS after deleting references to Iran. They were also informed of an HBEU proposal to streamline the processing of U-turn transactions by omitting references to Iran so the transactions would not be halted by the OFAC filter in the United States. Emails at the time show that senior HBUS officials expressed discomfort with the HBEU proposal, but took no other action to stop or prevent the activity already occurring.<sup>669</sup> In addition, HBUS' OFAC filter occasionally caught an Iranian-related transaction, sent by an HSBC affiliate, in which the identifying information had not been fully removed, demonstrating that undisclosed U-turns continued to be sent through HBUS correspondent accounts, but again, no HBUS personnel took further action to stop the activity. In 2003, the Iranian issue was discussed again when a new HBUS AML Director arrived, but once more, no decisive action was taken to put a stop to undisclosed U-turns.

Although HSBC Group Compliance was aware of HBUS' concerns, HBEU's practice of stripping information or using cover payments to conceal U-turn transactions involving Iran, and the fact that such undisclosed transactions were routinely slipping through HBUS accounts, HSBC Group did not prohibit the practice for years. In July 2005, HSBC Group issued a Group-wide directive, Group Circular Letter (GCL) 050047, barring all HSBC affiliates from engaging in U.S. dollar transactions in violation of OFAC regulations, but continued to allow their use of cover payments for permissible U-turn transactions, which meant the transactions would continue to circumvent the OFAC filter and individualized review by recipient U.S. banks. In April 2006, HSBC Group issued a second Group-wide directive, GCL 060011, requiring HSBC affiliates and other financial institutions to use fully transparent payment instructions when sending transactions through HBUS accounts, but again allowed U-turns "to be made as cover payments." In 2007, HSBC Group decided to exit Iran.

<sup>668</sup> See 12/2/2004 email from HBUS Denise Reilly to HBUS Michael Gallagher and others, "U-Turns," HSBC OCC 3407526-527; 12/15/2004 email from HSBC David Bagley to HSBC Marilyn Spearing and HBME David Hodgkinson, "Iran - OFAC," HSBC OCC 8874039; and 5/4/2005 email from HBUS Elizabeth Protomastro to HBUS Teresa Pesce and others, "Wire Payments Suspended," HSBC OCC 8874710.

<sup>669</sup> 7/11/2001 email from HBUS Douglas Stolberg to HBUS Denise Reilly, HBUS Joe Harpster, and HBUS Michael Gallagher, "Bank Melli," HSBC OCC 8876129.

In recent years, OFAC has sent over a dozen so-called Cautionary Letters to HBUS about incidents in which it failed to block a prohibited transaction, including transactions involving Iran.<sup>670</sup> In 2010, HSBC Group employed an outside auditor, Deloitte LLP, to identify and review OFAC sensitive transactions at HBUS over a seven-year period from 2001 to 2007. That review has so far examined 58 million payment messages involving assets of \$37 billion that passed through the key server, located in the United Kingdom, during that timeframe and identified OFAC sensitive U.S. dollar transactions involving assets totaling \$19.7 billion. The review identified almost 25,000 U.S. dollar transactions involving Iran, involving assets in excess of \$19.4 billion.<sup>671</sup> The vast majority of the Iranian transactions, ranging from 75% to 90% over the years, were sent through HBUS and other U.S. dollar accounts without disclosing any connection to Iran. While the affiliates may have viewed these U-turns as permissible under U.S. law, the absence of identifying information meant they did not trigger the OFAC filter or an individualized review by HBUS to make sure.

#### (b) Concealing Iranian Transactions

**2000 Notice Regarding Iranian Transactions.** On June 9, 2000, the HSBC Group AML Compliance head Susan Wright learned in an email that a client bank was using deceptive practices to send OFAC sensitive U.S. dollar transactions through U.S. correspondent accounts while evading detection by the OFAC filter.

In the June 9, 2000 email to Ms. Wright from an HSBC colleague, she was informed that a particular bank, whose name was redacted by HSBC from the email, was “automatically replacing a remitter’s name with that of” the bank.<sup>672</sup> The email stated that the bank planned to cease the practice by the end of June, but in the future, for OFAC sensitive transactions, would “arrange cover for the payment using MT202/203 remittances.” “MT202/203” refers to the SWIFT message or payment instructions used to execute bank-to-bank transfers. The email explained that bank-to-bank transfers did not require identifying the underlying party who originated the transaction or the ultimate beneficiary of the payment.<sup>673</sup> It also indicated that the bank planned to send a separate “MT100 message” to the recipient bank providing full payment details for the originator and ultimate beneficiary. The email stated: “In this way a payment, in US\$ can be made for an individual or

<sup>670</sup> Department of the Treasury, Office of Foreign Assets Control (OFAC) Cautionary Letters sent to HSBC, September 2008 – April 2012, PSI-OFAC-01-0001-015.

<sup>671</sup> Deloitte Review of OFAC transactions, “Results of the Transactions Review – UK Gateway, March 29, 2012,” HSBC-PSI-PROD-0197919-989, at 930.

<sup>672</sup> 6/9/2000 email from HSBC Bob Cooper to HSBC Susan Wright, “Significant Exception 2Q00-04,” HSBC OCC 8875192-193.

<sup>673</sup> Id.



company on the OFAC list, without the name being 'detected' by the OFAC filters that all US banks would apply."<sup>674</sup>

Ms. Wright forwarded the June 2000 email to Matthew King, then head of HSBC Group Compliance, describing the client bank's past procedure of altering transaction documentation when processing OFAC sensitive wire transfers. She wrote: "We advised them that this was contrary to SWIFT guidelines (drawn up to address FATF<sup>675</sup> concerns re money laundering via wire transfers) which required that the full details (names and addresses) of remitters and beneficiaries are included."<sup>676</sup> She also described the client bank's future plan to conceal OFAC sensitive transactions behind bank-to-bank transfers. Ms. Wright wrote: "From a Group perspective I consider the continuation of this practice to be unacceptable and as a deliberate and calculated method to avoid the US OFAC sanctions has the potential to raise serious regulatory concerns and embarrass the Group."<sup>677</sup>

Ms. Wright's reaction indicates that as early as 2000, HSBC Group Compliance learned of practices being used to avoid detection by the OFAC filter, and viewed them as "unacceptable" and raising potential regulatory concerns that were capable of embarrassing HSBC.

**2001 Bank Melli Proposal.** Six months later, in January 2001, HBEU approached HBUS with a proposal to use its U.S. dollar correspondent account at HBUS to clear U.S. dollar transactions for Bank Melli, the largest commercial retail bank in Iran.<sup>678</sup> At that time, Bank Melli's London Branch maintained a U.S. dollar account with several other major international banks, but was interested in establishing a relationship with HSBC that would give the bank the majority of Bank Melli's U.S. dollar clearing business. HBEU conducted an extensive review, with advice from two outside U.S. law firms, to determine whether transactions originated by Bank Melli would meet the definition of a permissible U-turn transaction under OFAC regulations, and concluded that they would, in fact, be permissible.

Even though the proposed U-turns would be permissible under OFAC regulations, HBEU proposed carrying them out in the form of bank-to-bank transfers, without any reference to the underlying originator or ultimate beneficiary and, so without any reference to

<sup>674</sup> Id.

<sup>675</sup> FATF is the Financial Action Task Force, the leading international body that set standards for combating money laundering and terrorist financing.

<sup>676</sup> 6/14/2000 email from HSBC Susan Wright to HSBC Matthew King, "Memo: Significant Exception 2Q00-04," HSBC OCC 8875191-192.

<sup>677</sup> Id.

<sup>678</sup> HSBC had established a relationship with Bank Melli's office in Tehran in 1999. 7/11/2001 email from HBUS Carolyn Wind to HSBC Matthew King and others, "Bank Melli," HSBC-PSI-PROD-0096130-132.

Iran.<sup>679</sup> The aim was to ensure that the transactions would not be delayed by triggering an OFAC filter and having to undergo individualized review. HBUS compliance personnel responded that any such transactions would have to be done in a more transparent manner, with detailed payment information specifying the underlying originating and beneficiary customer information. HBUS employees expressed concern about using cover payments, since the limited payment instructions would not enable HBUS to know whether it was processing a valid U-turn transaction involving Iran or whether it was even processing a U-turn transaction at all.<sup>680</sup> It would see only two banks making the transfer on the payment instructions and would have no knowledge of the underlying customers for whom the transaction was being processed, including whether they were prohibited persons.

**Legal Advice.** In January 2001, HBUS OFAC Compliance officer Elizabeth Protomastro asked outside legal counsel, Tom Crocker, for an opinion as to whether HBUS could process U.S. dollar transactions from HBEU on behalf of either Bank Melli or Iran's Central Bank, Bank Markazi.<sup>681</sup> After extensive consultations involving two law firms and OFAC, HBUS was advised that the Bank Melli transactions could qualify as permissible U-turn transactions.<sup>682</sup>

<sup>679</sup> Id. at 0096130. Under international banking practice, it was legal for bank-to-bank transactions to omit underlying payment details for the originator and ultimate beneficiary. Subcommittee briefing by OFAC (5/8/2012).

<sup>680</sup> Id. at 0096130-131.

<sup>681</sup> See 1/31/2001 email from Elizabeth Protomastro to Tom Crocker, HSBC OCC 8903860.

<sup>682</sup> On February 1, 2001, HBEU provided Ms. Protomastro with more information about the type of U.S. dollar transactions that would be sent through HBEU's correspondent account at HBUS, explaining that they would include 25 treasury-related payments involving about \$750 million per day, 25 treasury-related receipts involving about \$750 million per day, and 100 commercial payments involving \$200 to \$300 million per day, none of which would be related to letters of credit for military goods. (See 2/1/2001 email from HBEU Peter Blenk to HBUS Elizabeth Protomastro, "Central Bank of Iran," HSBC OCC 8903864-865.) On February 2, 2001, Mr. Crocker advised that the scenario outlined by HBEU did not appear to qualify for the U-turn exception as stipulated in the OFAC Iranian Transactions Regulations, because HBEU could not serve as both the originating and receiving foreign bank. (See 2/2/2001 email from Tom Crocker to HBUS Elizabeth Protomastro, "Central Bank of Iran," HSBC OCC 8903859-860.)

In response to Mr. Crocker's opinion, on February 19, 2001, HSBC Group Compliance head Matthew King contacted a second law firm, Winthrop Brown, to obtain a second opinion. (See 2/19/2001 email from HSBC Matthew King to Winthrop Brown and HBME John Richards, "Memo: OFAC constraints in the Central Bank of Iran operating a USD Clearing account with HSBC Bank plc in London," HSBC OCC 8903876-877.) One of the firm's lawyers, John Simons, consulted with OFAC and obtained a copy of the payment processing procedure for qualified "U-Turn Dollar Clearing" transactions. He explained he was waiting to confirm with OFAC's Chief Counsel Office about whether a second U.S. bank was required to process permissible U-turn transactions. The email indicated that they had also determined that a requirement in Section 560.516 (b) for U.S. depository institutions to determine if an underlying transaction was prohibited by OFAC, "prior to initiating a payment on behalf of any customer or crediting a transfer to the account on its books of the ultimate beneficiary," did not apply to U-turns. (See 2/2001 email from John Simons to Winthrop Brown, "Memo: OFAC constraints in the Central Bank of Iran operating a USD Clearing account with HSBC Bank plc in London," HSBC OCC 8903875-876.)

In April 2001, Mr. Simons emailed Mr. King that OFAC had confirmed that a second U.S. bank was not required when processing permissible U-turn transactions and no specific

HSBC Group Compliance head Matthew King forwarded the legal advice to HBME officials Brian Richards and John Richards, stating: “I confirm I am happy for the business to be undertaken on this basis.” He also wrote: “I am assuming this business will be booked in HBEU, hence I am copying Chris Couldrey. If any other Group entity is likely to be involved, could you let me know.”<sup>683</sup> Brian Richards responded the following day to confirm that payment orders from Bank Melli’s account would originate from HBEU, and credits in favor of Bank Melli would be credited to their account at HBEU. He stated that the payment orders would not mention Bank Melli, and HBUS would not receive payment orders or receipts directly from an Iranian entity. Mr. Richards concluded that the payment chain would meet the U-turn definition provided by Mr. Simons.<sup>684</sup>

**HBEU Payment Instructions.** HBEU, HBUS, and HSBC Group Compliance continued to discuss HBEU’s proposal to process U.S. dollar transactions for Bank Melli.

In a letter dated April 30, 2001, HBEU’s Multicurrency Payments Department (MPD) sent Bank Melli a proposal to process their payments with “minimal manual intervention.”<sup>685</sup> The letter included payment templates with specific instructions on how to format U.S. dollar transactions so the paperwork would not have to be altered by HBEU. MPD proposed that Bank Melli use the provided templates to complete payments fields for both MT202 and MT100 SWIFT messages<sup>686</sup> and to test the proposal.<sup>687</sup> In the letter, MPD Business Development Manager John Fowle advised the Bank Melli Cash and Payments Manager in London, Saeed Pourjam:

“[F]ollowing tests in our payments environment we are confident that we have found a solution to processing your payments with minimal manual intervention. The key is to **always** populate **field 52** – if you do not have an ordering party name then quote “One of our Clients”, **never leave blank**. This means that the outgoing payment instruction from HSBC will not quote “Bank Melli” as sender – just HSBC London and whatever is in Field 52. This then

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OFAC license was required to engage in U-turn transactions. (See 4/26/2001 email from John Simons to HSBC Matthew King and others, OFAC – Iran,” HSBC OCC 8903868-870.)

<sup>683</sup> 4/26/2001 email from HSBC Matthew King to HBME Brian Richards and others, “OFAC – Iran,” HSBC OCC 8903868.

<sup>684</sup> 4/27/2001 email from HBME Brian Richards to HSBC Matthew King and others, “OFAC – Iran,” HSBC OCC 8903874.

<sup>685</sup> See 7/11/2001 email from HBUS Carolyn Wind to HSBC Matthew King and others, “Bank Melli,” HSBC OCC 8876130-136, at 135-136 (including a copy of the April letter).

<sup>686</sup> MT202 and MT100 are examples of SWIFT messages used by financial institutions to facilitate payment processing. Different messages utilize specialized formats, dependent on the type of transaction, to process the payments. Subcommittee briefing by OFAC (5/8/2012); Subcommittee briefing by Deloitte (5/5/2012).

<sup>687</sup> 7/11/2001 email from HBUS Carolyn Wind to HSBC Matthew King, “Bank Melli” HSBC OCC 8876130-136, at 133-136.

negates the need to quote “DO NOT MENTION OUR NAME IN NEW YORK” in field 72.”<sup>688</sup>

This email shows HBEU designed a payment method to avoid the OFAC filter by preventing the inclusion of information about the participation of the Iranian bank. The method developed by HBEU ensured that no language that would normally trigger an OFAC review – such as “do not mention our name in New York” – appeared in the transaction documentation.

On May 25, 2001, in an email to colleagues, Michael Gallagher, an HBUS senior official at the Payments and Cash Management (PCM) division, expressed discomfort with the Bank Melli proposal to colleagues, including his supervisor, Douglas Stolberg, head of Commercial and Institutional Banking (CIB): “I wish to be on the record as not comfortable with this piece of business.”<sup>689</sup> His statement did not elicit any immediate response. When interviewed, Mr. Gallagher told the Subcommittee that he sent this email to express his concerns to his colleagues, including his supervisor, and then left it to them to determine what should be done.<sup>690</sup>

In the meantime, HBEU had already begun processing Bank Melli U-turns through its account at HBUS, using cover payments so that the transactions would not trigger HBUS’ OFAC filter. This fact was disclosed in a June 28, 2001 email from the HBEU Institutional Banking Relationship Manager who handled the Bank Melli account, John Wilkinson.<sup>691</sup> In the email, he was discussing the Bank Melli proposal with the head of HBUS’ payment services, Denise Reilly. Mr. Wilkinson explained that once the proposal “goes live,” Bank Melli was instructed “to alter the format” of their payments to achieve straight through processing. Mr. Wilkinson wrote:

“[W]e have further asked them to only put ‘One of our clients’ in field 52, thus removing the chance of them inputting an ‘Iranian

<sup>688</sup> Id. at 135 (emphasis in original). Two months earlier, on May 21, 2001, HBEU Institutional Banking (CIB IBL) conducted a call with Bank Melli to inquire about the names of the principal beneficiaries of their payments. The resultant call report indicated that “as expected,” Bank Melli was unable to answer with the reasoning that Iran imports from many countries and suppliers worldwide. This information had been previously requested by a Senior Manager in Payment Operations at HBUS, Denise Reilly. An Area Manager within HBEU CIB IBL, Brian Richards, forwarded the response to Ms. Reilly the following day. Ms. Reilly then forwarded Mr. Richards’ email to HBUS Compliance personnel. 5/22/2001 email from HBUS Denise Reilly to HBUS Carolyn Wind and others, “Bank Melli,” HSBC-PSI-PROD-0096138-142.

<sup>689</sup> 5/25/2001 email from HBUS Michael Gallagher to HBUS Denise Reilly and Douglas Stolberg, “BANK MELLI,” HSBC-PSI-PROD-0096138.

<sup>690</sup> Subcommittee interview of Michael Gallagher (6/13/2012).

<sup>691</sup> 6/28/2001 email from HBEU John Wilkinson to HBUS Denise Reilly and others, “Bank Melli,” HSBC OCC 8876132-133, at 133.

referenced' customer name, that causes fall out of the cover payment sent to HBUS and a breach of OFAC regulations.”<sup>692</sup>

He also explained that using “One of our clients” in field 52 “is a standard phrase used by MPD [HBEU’s Multicurrency Payments Department] in these situations.”<sup>693</sup> Acknowledging Ms. Reilly’s concerns following “a recent formatting error” detailed in an earlier email of June 15, 2001, Mr. Wilkinson noted that Bank Melli had not yet begun to use the new formatting method detailed in the April letter:

“Bank Melli are still formatting payments in their usual method, in this instance MPD failed to spot the poor input and did not follow their normal procedure of altering the payment, hence it was blocked. MPD have again confirmed the new formatting method will achieve straight through processing and overcome these difficulties.”<sup>694</sup>

Mr. Wilkinson’s email shows that Bank Melli was already processing undisclosed U-turn transactions through HBEU’s account at HBUS, using what he calls “their usual method” for formatting the payments, prior to the proposed changes. His email also described HBEU’s “normal procedure” as “altering” Bank Melli’s payments to prevent the payments from being blocked. The proposed new procedure was aimed at eliminating those manual interventions on the part of HBEU to expedite payments, potentially saving time and therefore money.

This June 2001 email put HBUS on notice that HBEU had at times altered transactions involving Bank Melli in Iran, a practice already so commonplace at HBEU it was called its “normal procedure.” This email was sent to the head of HBUS’ payment service operations, who then alerted other HBUS executives. When asked about this document describing the alteration of documents being engaged in by an HSBC affiliate, senior HBUS Compliance official Anne Liddy, who oversaw HBUS’ OFAC compliance program, told the Subcommittee that it would have been a problem if U-turns were being processed in 2001, since HBUS did not then have a process in place to conduct U-turns appropriately.<sup>695</sup>

**HBUS Objections.** On July 11, 2001, after HBUS Compliance head Carolyn Wind learned of the HBEU proposal, she sent an email to HSBC Group Compliance head Matthew King objecting to it.<sup>696</sup> What followed was a growing consensus that HSBC should not be pursuing its

<sup>692</sup> Id.

<sup>693</sup> Id.

<sup>694</sup> Id.

<sup>695</sup> Subcommittee interview of Anne Liddy (2/22/2012).

<sup>696</sup> 7/11/2001 email from HBUS Carolyn Wind to HSBC Matthew King and others, “Bank Melli,” HSBC OCC 8876130-136.

business in this fashion. Ms. Wind included the Wilkinson email from June and a copy of the April letter sent to Bank Melli providing payment message instructions. Ms. Wind expressed several concerns, including whether the transactions sent via the cover payments would be permissible under OFAC regulations and that “HBUS will not be able to confirm whether or not the underlying transaction actually meets the ‘U-Turn’ requirement.” She noted further that it was “not apparent that HBEU will be able to confirm that each payment meets the requirements.” She wrote:

“In an effort to facilitate ‘straight-through processing’, it now appears that HBEU will train Bank Melli on formatting the payments and that we will be relying on Bank Melli to ensure that only qualifying payments are processed through HBEU’s account with HBUS.”<sup>697</sup>

Ms. Wind also expressed concern about how it might appear to U.S. regulators that HBEU trained Bank Melli to write payment instructions in such a way, pointing out that if OFAC were to identify a transaction that did not qualify as a permissible U-turn, OFAC might consider “HSBC’s actions due to the non-disclosure as having involved willful disregard or evasion.”<sup>698</sup>

HBUS payment services head Denise Reilly forwarded Ms. Wind’s email to Douglas Stolberg, head of HBUS Commercial and Institutional Banking (CIB). He responded: “With the amount of smoke coming off of this gun, remind me again why we think we should be supporting this business?”<sup>699</sup>

Ms. Reilly responded by sending Mr. Stolberg a memorandum prepared by the HSBC Group Representative for Iran, John Richards, which stated that HSBC Group “with the backing of Bond” – referring to the HSBC Chairman of the Board of Directors – wanted to “significantly grow our presence in Iran” with current lines of credit reported to be \$800 million, trade lines of \$150 million, and growth anticipated in trade, cash management and Internet banking. The memorandum indicated that HSBC Group and HBEU wanted to expand the bank’s presence in Iran and viewed clearing U.S. dollar transactions for Bank Melli as a profitable venture that could help win additional business in Iran, despite U.S. sanctions and HBUS concerns.<sup>700</sup>

<sup>697</sup> Id. at 130.

<sup>698</sup> Id. at 131.

<sup>699</sup> See 7/11/2001 email exchanges among HBUS Douglas Stolberg and HBUS Denise Reilly, Joe Harpster, and Michael Gallagher, “Bank Melli,” HSBC OCC 8876128-130.

<sup>700</sup> Id. at 128-129.

These email exchanges show that, by July 2001, senior HBUS compliance, payments, and business managers, as well as the HSBC Group Compliance head, were aware that Iranian U.S. dollar transaction documentation was being altered by HBEU and the transactions were being processed through HBUS.<sup>701</sup> HBUS Compliance head Carolyn Wind complained to HSBC Group Compliance head Matthew King, but neither stopped the practice, nor did HSBC Group obtain a legal opinion about whether its U.S. dollar cover payments were in compliance with OFAC regulations.

**HBUS' Payments Proposal.** In August 2001, HBUS offered its own proposed procedures to clear U.S. dollar transactions involving Bank Melli.<sup>702</sup> Uncomfortable with the formatting solution proposed by HBEU a few months prior, HBUS proposed that Bank Melli be listed as the originator in the payment instructions and proposed establishing a segregated account for the transactions so HBUS could ensure that all Bank Melli payments would be stopped by the OFAC filter for further review and approval.

On August 30, 2001, HSBC's John Richards expressed his support for the procedures, noting it would be the first time that an Iranian bank name was mentioned in the payment message.<sup>703</sup>

On September 6, 2001, HBUS met with the Director of the Office of Foreign Assets Control (OFAC) to discuss clearing Bank Melli U-turn transactions. Carolyn Wind commented that although OFAC did not approve or reject the proposal, she walked away from the meeting thinking that OFAC was "okay with it."<sup>704</sup>

**HBME's Iranian Transactions.** While HBEU was processing U-turn transactions for Bank Melli, a second HSBC affiliate, HSBC Middle East (HBME), was also carrying out OFAC sensitive transactions for other clients, using its own and HBEU's U.S. dollar correspondent accounts at HBUS apparently without alerting HBUS to the transactions. In an October 2001 email, David Bagley, then HBME Regional Head of Legal and Compliance, sought guidance from HSBC

<sup>701</sup> 7/11/2001 email exchange among HBUS Carolyn Wind, HBUS, Paul Lee, HBUS Anne Liddy, HBUS Douglas Stolberg, HBUS Michael Gallagher, and HBUS Denise Reilly, HSBC OCC 8876129.

<sup>702</sup> The procedures consisted of a two-step debit process and a five-step OFAC review process, and committed to same day processing for transactions determined to be U-turn compliant. The procedures required that Bank Melli transactions be segregated in an "HBEU Special Account" with the account number entered into the OFAC filter so that every Bank Melli transaction would be stopped in the OFAC queue for two reviews and two approvals prior to processing. Bank Melli would appear as the originator for all related transactions. 8/29/2001 email from HBUS Denise Reilly to HBAP Alan Wilkinson and others, "Bank Melli," HSBC OCC 7687346-348.

<sup>703</sup> 8/30/2001 email from HSBC John Richards to HBUS Denise Reilly and others, "Bank Melli," HSBC-PSI-PROD-0096147-148.

<sup>704</sup> Subcommittee interview of Carolyn Wind (3/7/2012).

Group Compliance head Matthew King about how OFAC sensitive transactions should be handled.<sup>705</sup> Mr. Bagley wrote: "As I understand the current position we do routinely, and across the Group, adopt differing approaches to payments potentially subject to OFAC sanctions." Mr. Bagley wrote that, at HBME, payments were not structured "against a specific request from the customer, rather we undertake this structuring as a routine," and that he was not clear about whether those procedures were viewed "as being inappropriate, and thus should be disallowed." He also noted: "I am advised that there may even be software in the UK which filters such payments for restructuring in the event that the original message has been structured in such a way that it will be caught by the OFAC filters."

Mr. Bagley cautioned that subjecting all OFAC sensitive payments to the OFAC filter for further review and approval would likely hurt business. He wrote: "disallowing all payments which are potentially subject to the OFAC process," or the alternative of forwarding "messages in such a way that they would be caught," would have a "significant affect" upon HBME's business within the Middle East and the Group's business within correspondent banking. He also wrote: "given the likely volumes it is impractical to submit each payment to a process of referral to HBUS," as HBUS had proposed. He concluded with a request for clear guidance: "I would be grateful for your clarification as to whether what is currently going on is acceptable, or whether we should be adopting a different practice."<sup>706</sup>

Mr. King responded that the September 11, 2001 terrorist attack on the United States required a reassessment. He wrote: "some of the routes traditionally used to avoid the impact of US OFAC sanctions may no longer be acceptable." Mr. King indicated that an automated screening system was being looked into, and in the interim asked that OFAC sensitive payments be vetted manually.<sup>707</sup>

Mr. Bagley's email alerted Mr. King to the fact that HBME, like HBEU, was routinely sending U.S. dollar transactions through its correspondent account at HBUS using methods intended to circumvent HBUS' OFAC filter. His email did not limit those transactions to Iranian U-turns, but sought broader guidance on acceptable practice. Mr. King wrote back: "all we can do is ask that payment from the affected countries are vetted manually."<sup>708</sup>

<sup>705</sup> 10/10/2001 email exchange among HSBC Matthew King and HBME David Bagley and others, "OFAC Sanctions," HSBC OCC 8873890-893, at 892.

<sup>706</sup> Id. at 892.

<sup>707</sup> Id. at 890.

<sup>708</sup> Id. at 890-891.



**(c) Pressuring HBUS on Iran**

In April 2002, HBME asked HBUS to re-circulate its proposed procedures for processing Iranian U-turn transactions,<sup>709</sup> indicating that the two affiliates were still attempting to reach agreement on the procedures to be used.<sup>710</sup>

**HBEU Draft Guidelines.** While the HBEU Relationship Manager for Institutional Banking in HBME, John Wilkinson, was trying to streamline the cover payments procedure used to send Iranian U-turns through HBEU's correspondent account at HBUS, HBEU Compliance was trying at the same time to put a stop to the practice altogether. On July 15, 2002, an HBEU Compliance officer forwarded draft guidelines for handling OFAC sensitive transactions to HBEU Compliance manager Julie Clarke and HBEU Multicurrency Payments Department (MPD) head Malcolm Eastwood and requested their approval.<sup>711</sup> The proposed guidelines stated in part that, although HBEU was not legally required to comply with U.S. OFAC prohibitions, "It is strongly recommended ... that RMs [Relationship Managers] do not deliberately take action aimed at assisting a customer to circumvent OFAC sanctions. For example payment instructions should not be amended by IBL staff." The proposed guidance also stated: "On no account should you deliberately guide, encourage or coerce the sender into amending the payment details so as to circumvent the OFAC sanctions. ... We will simply process as instructed."<sup>712</sup> The draft guidance relied on the following Group Policy:

"Group members should comply with both the letter and spirit of all relevant laws, codes, rules, regulations and standards of good market practice in each jurisdiction around the world where they conduct business."<sup>713</sup>

<sup>709</sup> 4/15/2002 email from HBUS Denise Reilly to HBEU John Wilkinson and others, "Bank Melli," HSBC OCC 7687376-377.

<sup>710</sup> According to Mr. Bagley, the HBEU Payment Services' December 2002 Compliance Certificate made explicit reference to its practice of altering Iranian U.S. dollar payments. Subcommittee interview of David Bagley (4/12/2012). Compliance Certificates from affiliates are normally consolidated and sent to HSBC Group Compliance for review, which would have provided a formal channel for addressing the issue. David Bagley told the Subcommittee, however, that the reference to U-turn transactions in HBEU's 2002 certificate was not incorporated into the consolidated Compliance Certificate and therefore was not formally escalated to Group Compliance for review. Id.

<sup>711</sup> 7/15/2002 email from HBEU Paul Proctor to HBEU Julie Clarke, HBEU Malcolm Eastwood, and others, "Monitoring of payment transactions against sanctions," HSBC OCC 8877103-106.

<sup>712</sup> Id. at 106.

<sup>713</sup> Id. at 105. The guidelines also noted that the responsibility for "policing payment and cheque clearings against sanctions" would move to Payment Services in the future.

These guidelines were later approved and became effective in the fall of 2003.<sup>714</sup> They show that HBEU Compliance and business personnel were aware of and concerned about potentially deceptive practices some could use to circumvent OFAC prohibitions.

**HBME Negotiations.** While HBEU Compliance developed the OFAC guidelines, Gary Boon, HBME Payment and Cash Management (PCM) sales manager in Dubai, spent the second half of 2002, making a concerted effort to reach agreement with HBUS on how to process U-turn transactions. On August 29, 2002, Mr. Boon emailed Denise Reilly and Nancy Hedges in HBUS Payment Operations, to encourage HBUS to officially approve the processing of U-turn transactions involving Iranian banks. He wrote: "I can now confirm that HSBC Bank plc, London does not have any processing or compliance issues in respect of USD payments from existing or new opportunities with Iranian Banks."<sup>715</sup> He also wrote that HBEU wanted "to ensure the payments are STP [straight through processing]," and HBEU would provide its clients with guidelines for formatting transactions to "ensure that our Iranian clients fully understand, when or how, payments could be rejected."<sup>716</sup> He indicated that he was seeking HBUS' formal agreement to process the U-turn transactions, from both a resource and reputational risk standpoint, "before I attempt to sell a USD clearing proposition."<sup>717</sup>

On October 8, 2002, Mr. Boon sent an email to senior HBUS Compliance official, Anne Liddy, seeking feedback on the HBEU proposal.<sup>718</sup> Ms. Liddy responded that the position of HBUS Compliance remained unchanged "in that all transactions involving Bank Melli must be fully disclosed and represented in one single transaction that reflects the complete flow of funds."<sup>719</sup> Ms. Liddy noted that the HBUS proposed procedures had been approved by Legal Counsel as meeting OFAC requirements. She also stated that HBUS and HBEU needed to reach agreement on the payment procedures before HBUS Compliance would present an official proposal to HBUS' Senior Management Committee or OFAC for approval. Ms. Liddy was also clear that these steps had to be taken prior to HBEU's making any proposal to Bank Melli or another Iranian bank.<sup>720</sup>

Mr. Boon responded on the same day that HBEU would soon be complying with the Financial Action Task Force (FATF) regulations

<sup>714</sup> See 9/8/2003 email from HBEU Julie Clarke to HBEU Paul Proctor and others, "OFAC sanctions evasion – Iranian payments," HSBC OCC 8876819-820.

<sup>715</sup> 8/29/2002 email from HBME Gary Boon to HBUS Nancy Hedges, HBUS Denise Reilly, and others, "IRAN-USD PAYMENTS," HSBC OCC 0948193-195.

<sup>716</sup> *Id.* at 194.

<sup>717</sup> *Id.*

<sup>718</sup> See 10/08/2002 email exchanges among HBUS Anne Liddy, HBME Gary Boon, and others, "Bank Melli," HSBC OCC 7687374-375.

<sup>719</sup> *Id.* at 375.

<sup>720</sup> *Id.*

requiring full disclosure of payment details on MT100/MT103 message formats, which was already part of the HBEU proposal since HBEU sent those messages to the bank receiving a U-turn payment in addition to sending a cover payment on a MT202 form. He indicated that the payments sent to HBUS fall into the category of permissible U-turn transactions, and noted that HBUS was already processing U.S. dollar transactions through two existing accounts in London.<sup>721</sup> Mr. Boon wrote: "The majority of payments will be processed with HBEU sending a MT100/MT103 to the beneficiary bank and HBUS will receive the MT202 cover payment (again your already doing this)."<sup>722</sup> He indicated that, due to "massive opportunities," he would like to resolve the procedural issues prior to a scheduled visit to Iran in November 2002.<sup>723</sup> In response, Ms. Liddy reluctantly set up a conference call with Mr. Boon and included Carolyn Wind and Denise Reilly.<sup>724</sup>

When asked about this email, Ms. Liddy told the Subcommittee that she did not understand his email and may have misinterpreted Mr. Boon's assertion that HBUS was already processing Iranian payments through existing accounts in London to mean that the issue affected London accounts, but not accounts in the United States.<sup>725</sup> She said that she became more concerned two months later, in December 2002, when a Bank Melli payment was caught in HBUS' OFAC filter.<sup>726</sup> Carolyn Wind told the Subcommittee that she was surprised by Mr. Boon's email and didn't know what his comments meant. Ms. Wind said that she contacted HSBC Group Compliance head Matthew King to follow-up, but didn't know what action he took, if any.<sup>727</sup>

The results of the conference call between HBME and HBUS were discussed in email correspondence later that month. On October 28, 2002, Mr. Boon wrote to Denise Reilly requesting an update. Ms. Reilly responded that HBUS had spoken with OFAC; the "MT100/MT103 and MT202 normal cover payment process has been deemed unacceptable"; and OFAC required "full disclosure of the transaction."<sup>728</sup> Mr. Boon and Ms. Reilly then agreed that HBEU should open a separate "Special nostro account" for all U-turn transactions to ensure each transaction

<sup>721</sup> Id. at 374-375.

<sup>722</sup> Id. at 375.

<sup>723</sup> 10/17/2002 email from Gary Boon to Anne Liddy, "IRAN," HSBC OCC 7687373.

<sup>724</sup> 10/21/2002 email from Anne Liddy to Carolyn Wind and Denise Reilly, "IRAN," HSBC OCC 7687373.

<sup>725</sup> Subcommittee interview of Anne Liddy (2/22/2012).

<sup>726</sup> Id. See also 12/30/2002 email exchanges among HBUS Elizabeth Protomastro, HBUS Carolyn Wind, HBUS Anne Liddy, HBUS Denise Reilly, and HSBC David Bagley, "OFAC: PLC wire on behalf of Melli Bank PLC," HSBC OCC 8873909.

<sup>727</sup> Subcommittee interview of Carolyn Wind (3/07/2012).

<sup>728</sup> 10/29/2002 email from HBUS Denise Reilly to HBME Gary Boon and HBUS Nancy Hedges, "IRAN-USD Payments," HSBC OCC 0948192-193.

would be caught by the OFAC filter for review and approval.<sup>729</sup> Mr. Boon requested confirmation that if HBEU met those terms and the HBUS committee approved the proposal, that “HBUS would be in a position to potentially become Iran’s USD Clearing Agent, HBEU would be their USD Correspondent Bank?”<sup>730</sup> Ms. Reilly responded that the current proposal was to “process transactions on behalf of Bank Melli” and if the proposal were broader “then it should be included in the business rationale that we requested in our conference call earlier this week for presentation to HBUS senior management.”<sup>731</sup> She indicated that the HBUS Senior Management Committee was comprised of the President of the bank, key business heads, and the head of key support units. While these emails suggest HBUS Compliance was poised to present the Iranian U-turn proposal to the HBUS Senior Management Committee, there is no indication in the documentation that the committee ever received or approved it.

**Eastwood Memorandum.** In November 2002, HBEU Multicurrency Payments Department (MPD) head Malcolm Eastwood sent a memorandum to HBUS Payments Services head Denise Reilly and Geoff Armstrong expressing concern that HSBC was exposing itself to unnecessary risk by handling OFAC sensitive payments.<sup>732</sup> He wrote:

“I currently feel that we may be exposing ourselves to unnecessary and unacceptable Reputational and Operational Risk when we are handling payments originating from FIs [financial institutions] domiciled in or who are a local branch of an FI domiciled in an OFAC regulated country.”

Mr. Eastwood stated that HBEU’s current process was to send OFAC sensitive payments to HBUS via the “cover” payment method that made no mention of Iran or other prohibited countries.<sup>733</sup> He noted that two payments, one from Iran and one from Cuba, had recently been caught by HBUS’s OFAC filter. Mr. Eastwood stated that he wanted to resolve the situation, and “we therefore need to seek clarification of HBUS/OFAC’s stance so that we can determine our future payments strategy.”<sup>734</sup>

The Eastwood memorandum again put HBUS on notice regarding HBEU’s practice of concealing U-turn transactions behind cover payments and altering the payment instructions received from Iranian

<sup>729</sup> Id. at 192.

<sup>730</sup> Id.

<sup>731</sup> Id.

<sup>732</sup> 11/14/2002 memorandum from HBEU Malcolm Eastwood to HBUS Denise Reilly and HBEU Geoff Armstrong, “Compliance – OFAC Issues in General and Specific to Iran,” HSBC OCC 7688824.

<sup>733</sup> Id. at 825.

<sup>734</sup> Id.

banks. Mr. Eastwood wrote: “The Iranian banks continue to send us what I describe as conditional payment instructions which for HBEU require an element of amendment by ourselves.”<sup>735</sup> Mr. Eastwood warned: “If we cannot achieve this [a resolution on how to handle U-turn transactions] I will have to recommend to my General Manager a view that processing these payments is ‘unsafe’ and that these items should be filtered out and cancelled. This would have severe repercussions for our Group relationship within the Iranian FIs.”<sup>736</sup>

That same day, HBUS Payments Services head Denise Reilly forwarded the Eastwood memorandum to HBUS PCM head Michael Gallagher and HBUS Compliance head Carolyn Wind, with the note: “We need to discuss.”<sup>737</sup> HBUS records do not indicate whether that discussion took place. When asked about this email, Mr. Gallagher told the Subcommittee that he wasn’t sure he received Mr. Eastwood’s memorandum because he wasn’t named on it.<sup>738</sup> When shown another email indicating he had discussed the Eastwood memorandum again in December 2003, with the new HBUS AML head,<sup>739</sup> he told the Subcommittee that he did not recall the memorandum, any discussion of it, or taking any action in response to it.<sup>740</sup> When Carolyn Wind was asked about the Eastwood memorandum, she told the Subcommittee that HBUS kept “pushing back on U-turns.”<sup>741</sup>

**Do Not Mention Our Name.** In late December 2002, HBUS OFAC Compliance officer Elizabeth Protomastro notified Carolyn Wind, Denise Reilly, and Anne Liddy that, on December 27, 2002, the HBUS OFAC filter had stopped and rejected a payment listing Bank Melli as the originator of the payment and containing a field that read, “Do not mention our name in NY.” Ms. Protomastro advised rejecting all U-turn transactions containing such language. The language on the stopped transaction shows how information related to Iranian payments was intentionally withheld from HBUS. In response, Ms. Liddy went to Carolyn Wind’s office and spoke with her, Denise Reilly, and Paul Lee, HBUS’ Legal Counsel, about the transaction. She was told to alert David Bagley, who had become head of HSBC Group Compliance in January 2002.<sup>742</sup> That same day, Anne Liddy forwarded Ms.

<sup>735</sup> Id. at 826.

<sup>736</sup> Id.

<sup>737</sup> 11/14/2002 email from HBUS Denise Reilly to HBUS Carolyn Wind and HBUS Michael Gallagher, “Compliance – OFAC Issues in General and Specific to Iran,” HSBC OCC 7688822-827.

<sup>738</sup> Subcommittee interview of Michael Gallagher (6/13/2012).

<sup>739</sup> See 12/17/2003 email from HBUS Denise Reilly to HBUS Teresa Pesce, “Compliance – OFAC Issues in General and Specific to Iran,” HSBC OCC 3407517-522 (“Attached is the memo that we discussed yesterday in our meeting with Michael Gallagher.”).

<sup>740</sup> Subcommittee interview of Michael Gallagher (6/13/2012).

<sup>741</sup> Subcommittee interview of Carolyn Wind (3/7/2012).

<sup>742</sup> Subcommittee interview of Anne Liddy (2/22/2012). Mr. Bagley assumed the duties of HSBC Group Compliance head in January 2002, but his appointment did not become official until May 2002, after the U.K. Financial Services Authority approved it. Subcommittee

Protomastro's email to Mr. Bagley.<sup>743</sup> Ms. Liddy told the Subcommittee that she was concerned about the Bank Melli payment, because HBEU still had not obtained approval to do those types of transactions.<sup>744</sup> She told the Subcommittee that neither Mr. Bagley nor Ms. Wind provided any feedback on the incident, and she didn't know what action, if any, Mr. Bagley took.<sup>745</sup>

The 2002 Eastwood memorandum again put senior HBUS compliance and business officials on notice that HBEU was sending undisclosed OFAC sensitive transactions through its U.S. dollar correspondent accounts at HBUS. Again, HBUS officials alerted their superiors, but no further action was taken.

**(d) Continuing Pressure on HBUS to Process Iranian Transactions**

Although HBEU handled the Bank Melli account, it was HSBC Middle East (HBME) that was at the center of efforts to pressure HBUS to process Iranian transactions without triggering the OFAC filter. HBME took the lead in dealing with Iran and selling bank services to Iranian banks. In January 2003, HBME Group Relationship Manager for the Middle East, Nigel Weir, sent HBUS Payments Services head Denise Reilly and HBEU MPD head Malcolm Eastwood a memorandum entitled, "Business Case-USD Payments from Iranian Banks/Entities."<sup>746</sup> This HBME memorandum laid out the "business case" for HBUS' processing Iranian transactions using the procedures proposed by HBEU back in August 2001.<sup>747</sup> The memorandum stated:

"Currently, it is estimated that Iranian banks issue up to 700 USD payments a day using their USD service providers, mainly banks in the UK and Europe, which in turn use their New York USD correspondents to effect the payments. It is believed that some

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interview of David Bagley (5/10/2012); Subcommittee briefing by Cahill Gordon & Reindel LLP (6/20/2012).

<sup>743</sup> See 12/30/2002 email exchanges among HBUS Elizabeth Protomastro, HBUS Carolyn Wind, HBUS Anne Liddy, HBUS Denise Reilly, and HSBC David Bagley, "OFAC: PLC wire on behalf of Melli Bank PLC," HSBC OCC 8873909.

<sup>744</sup> Subcommittee interview of Anne Liddy (2/22/2012).

<sup>745</sup> Id. See also 12/30/2002 email exchanges among HBUS Elizabeth Protomastro, HBUS Carolyn Wind, HBUS Anne Liddy, HBUS Denise Reilly, and HSBC David Bagley, "OFAC: PLC wire on behalf of Melli Bank PLC," HSBC OCC 8873909.

<sup>746</sup> 1/2003 memo from HBME Rick Pudner to HBUS Denise Reilly and HBEU Malcolm Eastwood and others, "Business Case-USD Payments From Iranian Banks/Entities," HSBC OCC 8876490-493; 1/21/2003 email exchanges among HBUS Anne Liddy, HBUS Carolyn Wind, HBUS Denise Reilly, and others, HSBC OCC 3407510. Nigel Weir and Rick Pudner were joint authors of the memorandum.

<sup>747</sup> Id. at 1. The memorandum stated: "This paper has been produced in order for the Senior Management Committee (SMC) of HSBC Bank USA (HBUS) to evaluate whether or not HBUS will process US dollar (USD) payments initiated by Iranian Banks via accounts held with HSBC Bank Plc (HBEU)." Id.

service providers amend the payments to ensure Iran is not mentioned in the body of the payment instruction to their USD correspondent. This process minimizes the risk of payment being referred to OFAC.”<sup>748</sup>

The memorandum did not state explicitly that both HBME and HBEU were already engaged in the same practice using their U.S. dollar accounts at HBUS.

The HBME memorandum stated that HBME “believe[s] there is a substantial income opportunity to see a USD payments proposition to Iranian Banks,” and provided an appendix detailing existing and potential business opportunities in Iran, while noting HBEU already had a “number of existing USD accounts for Iranian banks, which are used for payments clearing purposes.”<sup>749</sup> The memorandum concluded:

“It is anticipated that Iran will become a source of increasing income for the group going forward and if we are to achieve this goal we must adopt a positive stance when encountering difficulties. We are aware of the concerns expressed by HBUS but strongly believe that by working together we can overcome them using means which are perfectly legitimate and in accordance with rules laid down by the relevant regulatory bodies. I hope we will be able to resolve this issue otherwise I fear we will destroy future value in a market which has substantial potential for the group.”<sup>750</sup>

HBME asked that the business case be presented to HBUS’ Senior Management Committee at the earliest opportunity.

On January 16, 2003, Denise Reilly forwarded the HBME memorandum to HBUS Compliance officials Carolyn Wind and Anne Liddy.<sup>751</sup> On January 21, 2003, Ms. Liddy forwarded it to Tom Crocker, the outside legal counsel advising HBUS on OFAC matters.<sup>752</sup> When asked about the memorandum, Ms. Liddy told the Subcommittee she did not recall it or the outcome of Mr. Crocker’s review.<sup>753</sup>

<sup>748</sup> Id. at 490.

<sup>749</sup> Id. at 493. Internal bank documents indicate that HBEU cleared U.S. dollar transactions through its correspondent account at HBUS for at least six Iranian banks, Bank Melli, Bank Kesharvazi, Bank Markazi, Bank Sepah, Bank Tejarat, and the Export Development Bank of Iran. See, e.g., 10/23/2003 email from HSBC John Root to HSBC David Bagley and others, “USD Clearing – Iranian Banks,” HSBC OCC 8875217. HBEU senior payments official Rod Moxley told the Subcommittee that he believed seven or eight Iranian banks used HSBC for U.S. dollar correspondent services. Subcommittee interview of Rod Moxley (6/07/2012).

<sup>750</sup> 1/2003 memo from HBME Rick Pudner to HBUS Denise Reilly and HBEU Malcolm Eastwood and others, “Business Case-USD Payments From Iranian Banks/Entities,” HSBC OCC 8876-493, at 492.

<sup>751</sup> Subcommittee interview of Anne Liddy (2/22/2012).

<sup>752</sup> See 1/21/2003 email from HBUS Anne Liddy to External Counsel Tom Crocker and others, “USD Payments from Iranian Banks,” HSBC OCC 3407510-511.

<sup>753</sup> Subcommittee interview of Anne Liddy (2/22/2012).

On February 3, 2003, HSBC Group Compliance head David Bagley sent an email to HBME, where he used to work, discussing the issue.<sup>754</sup> He conveyed that he had asked senior Compliance official John Root to review the OFAC issue from a Group perspective. He also wrote that he “would be grateful if we could exercise greater care with regard to the content of written material” being sent to HBUS, explaining: “The business case includes a number of express references to practices which may constitute a breach of US sanctions, including the OFAC provisions, and could provide the basis for action against the HSBC Group for breach of those sanctions, or seeking to facilitate a breach.”<sup>755</sup> Mr. Bagley requested that future communications regarding this subject be cleared through him or John Root “to avoid relative sensitive references,” prior to involving HBUS.<sup>756</sup> The recipient of the email, Nigel Weir, responded that the memorandum was intended to recommend pursuing a significant business opportunity, while complying with applicable regulations.<sup>757</sup> Mr. Bagley told the Subcommittee that this was the first time, in his role as head of HSBC Group Compliance, he addressed the OFAC issue. He noted that HBME’s actions could potentially “constitute a breach of US sanctions,” yet it would take him two more years, until July 2005, to establish Group policy prohibiting such conduct.

Again, there was no indication that a proposal for handling Iranian U-turn transactions was ever presented to or approved by HBUS’ Senior Management Committee. At the same time, undisclosed transactions continued to be sent by HSBC affiliates through their correspondent accounts at HBUS. A later analysis performed by an outside auditor at HBUS’ request found that, in 2002 alone, HBEU sent at least 1,900 and HBME sent at least 400 Iranian transactions through U.S. dollar accounts in the United States.<sup>758</sup>

**Caught in the OFAC Filter.** On June 13, 2003, another Bank Melli transaction was caught in the HBUS OFAC filter, containing not only a reference to the bank, but also the words “do not mention our name.”<sup>759</sup> On June 16, 2003, HBUS OFAC Compliance officer

<sup>754</sup> 2/3/2003 email from HBUS David Bagley to HBME Rick Pudner and others, “Business Case-US Payments From Iranian Banks/Entities,” HSBC OCC 8876487-488.

<sup>755</sup> Id.

<sup>756</sup> Id. at 488.

<sup>757</sup> 2/3/2003 email from HBME Nigel Weir to HSBC David Bagley and others, “Business Case-US Payments From Iranian Banks/Entities,” HSBC OCC 8876487.

<sup>758</sup> Deloitte, Results of the transactions Review – UK Gateway, March 29, 2012. HSBC-PSI-PROD-0197919, at 62. The Deloitte review examined HBEU and HBME Iranian transactions sent through U.S. dollar accounts at both HBUS and JPMorgan Chase.

<sup>759</sup> See 6/17/2003 email from HBUS Elizabeth Protomastro to HSBC John Root and HBUS Carolyn Wind, “Re: PLC-Re “do not mention our name,” at HSBC OCC 8873922.



Elizabeth Protomastro alerted both Carolyn Wind and Anne Liddy.<sup>760</sup> Ms. Wind forwarded the email to HSBC Group Compliance officer John Root, and Ms. Protomastro provided him with additional details about the payment, including that it involved \$150,000. She explained that when the HBUS Funds Transfer staff saw the message “do not mention our name,” they rejected the payment in accordance with HBUS policy, “due to concerns about evasion issues under the OFAC regulations.”<sup>761</sup> Ms. Protomastro explained that HBUS would not process a payment containing such a message, even if it qualified as a permissible U-turn transaction.

On June 17, 2003, Mr. Root forwarded the payment details to HSBC Group Compliance head David Bagley.<sup>762</sup> Mr. Bagley responded by asking if they should allow a payment “with this sort of instruction to be passed to HBUS, regardless of the wider issue as to the applicability of OFAC to non us persons.”<sup>763</sup>

The June 2003 transaction once again made several senior officials at HBUS and HSBC Group aware that HSBC affiliates were sending undisclosed OFAC sensitive transactions through HBUS accounts, even though HBUS had yet to approve a U-turn protocol. When asked about this incident, Ms. Wind told the Subcommittee that she did not recall what HSBC Group Compliance said or did about the payment.<sup>764</sup> She also did not recall whether there was an inquiry made to identify similar transactions, whether the transaction was reported to OFAC, or whether a SAR was considered or filed. When asked who in HBUS was responsible for following up on the incident, she replied that from the business side, Denise Reilly and her supervisor Michael Gallagher, and from the compliance side, herself and Anne Liddy.<sup>765</sup> When Mr. Gallagher was asked about the incident, he responded that it was not his responsibility to take action, because blocked payments are an operational and compliance effort, not a PCM issue.<sup>766</sup> He stated that he would not have had the authority to either stop or release a suspect payment; operations staff, including Denise Reilly, did not report to Mr. Gallagher in 2003.

**Using “Selves” Instead of Client Names.** In August 2003, internal bank documents show that Compliance personnel in HSBC Group and HBEU learned of, and objected to, the practice of some

<sup>760</sup> 6/16/2003 email from HBUS Elizabeth Protomastro to HBUS Carolyn Wind and HBUS Anne Liddy, “PLC-Re “do not mention our name,” HSBC OCC 8873925.

<sup>761</sup> 6/17/2003 email from HBUS Elizabeth Protomastro to HSBC John Root and HBUS Carolyn Wind, “Re: PLC-Re “do not mention our name,” HSBC OCC 8873922-923.

<sup>762</sup> Id.

<sup>763</sup> Id.

<sup>764</sup> Subcommittee interview of Carolyn Wind (3/7/2012).

<sup>765</sup> Id.

<sup>766</sup> Subcommittee interview of Michael Gallagher (6/13/2012).

HBEU personnel, when sending Iranian U-turn transactions, to alter the payment instructions and identify HBEU itself as the active party in the transaction, rather than use a client name that might trigger HBUS' OFAC filter. Despite their objections, the practice continued for years.

On August 20, 2003, the head of HSBC Group Audit Matthew King informed HSBC Group Compliance head David Bagley that "HBEU continues to send remittances to the US with 'selves' noted as the ordering party when the transfer would otherwise be filtered out for OFAC sanctions reasons."<sup>767</sup> He wrote: "I recall that this has been raised in the past, but I thought we had agreed the practice would cease. Are you aware of the current position?"<sup>768</sup>

On September 1, 2003, Mr. Bagley forwarded Mr. King's email to John Root and asked him to investigate.<sup>769</sup> Mr. Bagley wrote that there is now "some clarity" that OFAC prohibitions do not apply to non-U.S. persons, even when payments are denominated in U.S. dollars.<sup>770</sup> He also wrote that an established payment mechanism exists for bank-to-bank transfers, which did not require underlying payment information and which might apply to HBEU transfers to HBUS.<sup>771</sup> Mr. Root agreed to look into the matter.

On September 2, 2003, HBEU Compliance manager Julie Clarke sent an email to an individual whose name was redacted by HSBC seeking more information about the transactions that triggered the inquiry by HSBC Group Audit head Matthew King.<sup>772</sup> The email recipient responded:

"During the conversation, I mentioned that historically we used 'selves' but that I had stopped the practice as soon as I had discovered it in mid-2000. He stated that it was still done in HBEU. This was not in connection with [redacted] payments and I have no examples."<sup>773</sup>

<sup>767</sup> 8/20/2003 email from HSBC Matthew King to HSBC David Bagley and others, "OFAC," HSBC OCC 8876504-505.

<sup>768</sup> Id. at 505.

<sup>769</sup> 9/1/2003 email from HSBC David Bagley to HSBC John Root and HSBC John Allison, "OFAC," HSBC OCC 8876504.

<sup>770</sup> Id. Mr. Bagley told the Subcommittee that the applicability of OFAC prohibitions to non-U.S. persons was an undecided issue in 2003, with legal opinions offering differing conclusions. Subcommittee interview of David Bagley (4/12/2012). OFAC now takes the position that its prohibitions apply to all U.S. dollar transactions, including those involving non-U.S. persons.

<sup>771</sup> 9/1/2003 email from HSBC David Bagley to HSBC John Root and HSBC John Allison, "OFAC," HSBC OCC 8876504. As explained earlier, at that time, bank-to-bank transfers could be executed on forms which required information on the remitting and beneficiary banks, but not the underlying customers.

<sup>772</sup> 9/2/2003 email from HBEU Julie Clarke to [redacted], "OFAC sanctions," HSBC OCC 8876824-825.

<sup>773</sup> Id. at 8876824.

The following day Ms. Clarke forwarded the email to Rod Moxley in HBEU's Multicurrency Payment Department (MPD), and asked him for more information regarding the practice of using "ourselves" in a payment message.<sup>774</sup>

On September 8, 2003, Mr. Moxley responded to Ms. Clarke.<sup>775</sup> He explained that the OFAC sanctions issue had been "under discussion for some time" within MPD.<sup>776</sup> He forwarded to her an August email that he had sent to Pat Conroy, Malcolm Eastwood's supervisor, addressing various issues related to OFAC sensitive transactions. The August email indicated that a certain person, whose name was redacted by HSBC, had brought "our current practice regarding the alteration of the remitter field on Iranian payments to the attention" of Matthew King and David Bagley.<sup>777</sup> The August email also stated that "[t]he specific issue with Iran had been formally raised with the RM [Relationship Manager], John Wilkinson" who had been "given a deadline of 31 December 2003 to remedy this situation." The August email also noted: "Malcolm's stance, I understand, is that any payments after 31 December 2003 will not be processed unless signed off at a very senior level."<sup>778</sup>

That same day, September 8, 2003, Ms. Clarke forwarded the email chain to HBEU Compliance officer Paul Proctor and wrote: "It appears that John Wilkinson has been allowed to continue (to 31/12/03) to use 'selves' as the remitter name for Iranian payments which I believe contravenes your recently issued guidelines."<sup>779</sup> Mr. Proctor responded:

"This is the first time I have seen in writing, an admission that Payments Services are amending payments by removal of either the remitter's name or country to prevent the probable trigger of the US filter and the subsequent freezing of funds.

You indicate that Group Compliance have now forbidden you to tamper with such payments, which I would fully support as it flies in the face of Group policy re complying with the spirit and letter etc."<sup>780</sup>

<sup>774</sup> 9/3/2003 email from HBEU Julie Clarke to HBEU Rod Moxley and Chris Pollard, "OFAC Sanctions," HSBC OCC 8876824.

<sup>775</sup> 9/8/2003 email from HBEU Rod Moxley to HBEU Julie Clarke, "OFAC Sanctions," HSBC OCC 8876820-821.

<sup>776</sup> Id. at 8876821.

<sup>777</sup> 8/22/2003 email from HBEU Rod Moxley to HBEU Pat Conroy, "Project Wolf," HSBC OCC 8876821-822.

<sup>778</sup> Id.

<sup>779</sup> 9/8/2003 email from HBEU Julie Clarke to HBEU Paul Proctor and others, "OFAC sanctions evasion – Iranian payments," HSBC OCC 8876819-820.

<sup>780</sup> 9/8/2003 email from HBEU Paul Proctor to HBEU Julie Clarke and others, "Re: OFAC sanctions evasion – Iranian payments," HSBC OCC 8876818-819.

This email indicates that HBEU Compliance had not been aware that some HBEU personnel were continuing to alter documentation connected to OFAC sensitive transactions, in defiance of new guidelines prohibiting such conduct. The email also indicates that HSBC Group Compliance had instructed HBEU Compliance that HBEU personnel were “forbidden” to “tamper” with the documentation.

When asked about these emails, Mr. Bagley told the Subcommittee that, in October 2003, Mr. Root reported to him that HBEU Compliance had admitted HBEU was still altering Iranian U-turn transaction documentation, despite a recommendation by HBEU Compliance that it cease.<sup>781</sup> Mr. Bagley told the Subcommittee that HBEU had explained that it had been sued when payments were blocked by the HBUS filter, so it was using cover payments to avoid additional operational losses.<sup>782</sup> Mr. Bagley also explained that neither HBEU Compliance nor HSBC Group Compliance could simply order a business unit to cease a particular practice; each could only “recommend” a course of action which it had done.

The internal bank documents show that, in the fall of 2003, Mr. Eastwood and Mr. Moxley in MPD, HBEU Compliance manager Julie Clarke and Compliance officer Paul Proctor, as well as the heads of HSBC Group Audit and Compliance, expressed repeated concern about actions taken by persons like the HBEU Relationship Manager for Bank Melli John Wilkinson to alter U-turn transaction documentation in a way that would avoid the OFAC filter; all agreed the practice should stop. HBEU Compliance took the step of issuing guidelines recommending against such conduct, but HBEU personnel apparently ignored the guidance.

**Proposal to Expand U.S. Dollar Clearing for Iranian Banks.** In October 2003, HBME increased the pressure on HBUS to process Iranian transactions by proposing to expand its U.S. dollar clearing business in Iran. In early October, HBME Planning head Steve Banner circulated a document entitled, “Iran - Strategy Discussion Paper,” to several senior bank executives, including HBME Deputy Chairman David Hodgkinson; HBME Global Relationship Manager for the Middle East Nigel Weir; HSBC Group Compliance deputy head Warren Leaming, HBUS General Counsel Paul Lee, and HBUS Compliance head Carolyn Wind.<sup>783</sup> The strategy essentially sought approval for HBME offering U.S. dollar payment services to more Iranian banks since, as the strategy noted, “the Iranian market offers substantial untapped potential for the HSBC Group.”<sup>784</sup>

<sup>781</sup> Subcommittee interview of David Bagley (5/10/2012).

<sup>782</sup> Id.

<sup>783</sup> Undated HSBC document, “Iran – Strategy Discussion Paper,” HSBC OCC 8873949-956.

<sup>784</sup> Id. at 949.

The strategy listed “significant business wins” involving Iran, in the Project and Export Finance, Trade Finance, and Treasury and Capital Markets areas with an estimated \$7 million per year in revenues generated by Iranian businesses for “various Group entities.”<sup>785</sup> In a section entitled, “Phase 1 – Immediate Opportunities,” the strategy stated that Iran’s annual international trade business was valued at \$25 billion, 80% of which was denominated in U.S. dollars. It stated that HBEU PCM currently offered U.S. dollar payment services to four Iranian banks, and could market the same services “to other Iranian commercial banks, including Iran’s Central Bank (Bank Markazi).” It estimated the potential business as worth up to \$4 million per year.

The strategy also noted an upcoming change in U.K. law that would require U.K. bank-to-bank transfers to identify, not only the banks involved in the transfer, but also their underlying customers. It stated that the impending U.K. legislation, together with U.S. sanctions laws, would “significantly complicate the USD payments process for Iranian counter-parties,” and if “the Group decides to pro-actively promote USD payments services to Iranian banks the payments will need to be processed by HBUS with full details to satisfy OFAC requirements.”<sup>786</sup> To facilitate the process, the strategy said that HBME planned to prepare a paper for HSBC Group requesting an increase in the country risk limits for Iran.<sup>787</sup> The strategy concluded by asking for HSBC Group’s approval and HBUS’ “no objection” to HBEU’s providing U.S. dollar services to additional Iranian banks.<sup>788</sup>

The strategy stated clearly that, “HBEU PCM currently offer[s] USD [U.S. dollar] payment services to 4 Iranian banks.”<sup>789</sup> It once again alerted HBUS to the fact that HBEU was already processing U.S. dollar transactions for Iranian banks through its account at HBUS. The strategy was sent to both HBUS’ legal counsel and top compliance officer.

On October 15, 2003, the HBUS CEO at the time, Youssef Nasr, sent an email to HBUS PCM head Michael Gallagher noting that with regard to Iranian U-turns, “there remain serious political and reputational risks within the USA if they proceed with this and that he should ensure that Paul Lee is kept in the loop at all times because of the prior work he has done both on this and some recent approaches from Group offices about opportunities in Libya.”<sup>790</sup> When asked if Mr. Gallagher discussed the strategy paper with Mr. Nasr, Mr. Gallagher told

<sup>785</sup> Id. at 951.

<sup>786</sup> Id. at 954.

<sup>787</sup> Id. at 952.

<sup>788</sup> Id. at 955.

<sup>789</sup> Id. at 952.

<sup>790</sup> 10/15/2003 email from HBUS Youssef Nasr to HBUS Michael Gallagher, “Subject, Re: Iran-USD Payments,” HSBC OCC 8873942.

the Subcommittee that he did not recall seeing it.<sup>791</sup> On October 21, 2003, HBUS General Counsel Paul Lee contacted HSBC Group Compliance head David Bagley “expressing some concerns” about the Iranian strategy.<sup>792</sup>

On October 21, 2003, Mr. Bagley sent an email to HBME officials indicating several issues surrounding the U-turn transactions needed clarification and asked whether the costs associated with incurring U.S. legal fees made it worthwhile to continue the discussion. Mr. Bagley also wrote:

“I am not sure that HBUS are aware of the fact that HBEU are already providing clearing facilities for four Iranian banks, presumably including USD [U.S. dollar] clearance. Bank Markazi is named in the OFAC sanctions as a government owned bank and thus on the face of it not able to benefit from U-turn exemptions.”<sup>793</sup>

On October 26, 2003, HBME Deputy Chairman David Hodgkinson sent an email in response to Mr. Bagley. He wrote: “HSBC earns USD7.5m a year from its business dealings with Iran and we believe that there is significant long-term potential for growth.”<sup>794</sup> Mr. Hodgkinson indicated that he was willing to incur costs to investigate the options and find “an acceptable way to offer the maximum range of services possible without jeopardizing the Group’s position in the U.S.”<sup>795</sup> Mr. Bagley then directed senior Compliance official John Root to work with Gary Boon at HBME on a payment solution.<sup>796</sup>

**Root Report.** As he had been instructed to do by Mr. Bagley, John Root looked into the Iranian U-turn issue. On October 23, 2003, Mr. Root sent an email to Mr. Bagley, HSBC Group AML head Susan Wright, Money Laundering Control Officer John Allison, and HBEU Compliance officer Paul Proctor. Mr. Root wrote that the Iranian relationship at HBEU consisted of a U.S. dollar clearing service volume of approximately 11 payments every business day for six banks: Melli, Keshavarzi, Markazi, Sepah, Tejarat, and the Export Development Bank.<sup>797</sup> His email again confirmed that HBEU was altering the

<sup>791</sup> Subcommittee interview of Michael Gallagher (6/13/2012).

<sup>792</sup> See 10/21/2003 email exchange among HSBC David Bagley, HBME Steve Banner, and others, “Iran-Strategy Discussion Paper,” HSBC OCC 8873946-947.

<sup>793</sup> Id.

<sup>794</sup> 10/26/2003 email from HBME David Hodgkinson to HSBC David Bagley, “Iran-Strategy Discussion Paper,” HSBC OCC 8873959.

<sup>795</sup> Id.

<sup>796</sup> Subcommittee interview of David Bagley (5/10/2012). See also 10/28/2003 email from HSBC David Bagley to HBME Ajay Bhandoola, “Memo: Iran-Strategy Discussion Paper,” HSBC OCC 8873958.

<sup>797</sup> Mr. Root identified two more banks than were referenced in the October Iran strategy paper.

payment documentation, despite HSBC Group Audit head, Matthew King's having expressed concerns about the practice, and the HBEU Compliance guidelines calling for the practice to stop by the end of the year. Mr. Root wrote:

"EPS [the payment services team within MPD where Mr. Eastwood and Mr. Moxley worked] HBEU have been manually intervening in the processing of Iranian bank payment instructions by removing the remitter's name and country to prevent the probable trigger of a filter in the US, and the subsequent declaration to OFAC (and possible freezing) of the funds."<sup>798</sup>

Mr. Root wrote that he believed EPS had been instructed by HBEU Compliance to cease this practice, but was unclear when the instructions were given or by whom. He noted that HBEU Institutional Banking (IBL) had negotiated an extension until December 31, 2003, due to "long-standing valuable relationships." After the December 31, 2003 deadline, Mr. Root stated that cover payments would be considered unacceptable, and EPS would have to send HBUS fully formatted payment instructions on a MT100/103 serial basis.

Mr. Root also noted that Project WOLF, an HSBC Group project developing an automated payment filter to screen transactions for terrorists, would not ensure HBEU compliance with U-turn regulations in the United States. As a result, he said that HBUS would continue to be responsible for screening all U.S. dollar transactions with regard to OFAC prohibitions.<sup>799</sup>

**Moxley Deadline.** The following day, John Root forwarded David Bagley, Susan Wright, and John Allison an email from Rod Moxley in HBEU's Multicurrency Payments Department (MPD) expressing Mr. Moxley's objection to participating in procedures designed to conceal U-turn transactions. In his October 24, 2003 email, Mr. Moxley first objected to the notion that the MPD procedures being used for Iranian transactions were new or unknown:

"I have been alarmed by recent inferences that Payment Services have been amending the Iranian banks' payments without the knowledge or consent of IBAI RIM or IBL Compliance. This has been a long standing practice and to avoid future doubt, I will reiterate the points made in Malcolm Eastwood's memo to Niger Weir of 22 Jan. 03."<sup>800</sup>

<sup>798</sup> 10/23/2003 email from HSBC John Root to HSBC David Bagley and others, "USD Clearing – Iranian Banks," HSBC OCC 8875217.

<sup>799</sup> Id. at 217.

<sup>800</sup> 10/24/2003 email from HBEU Rod Moxley to HBEU John Wilkinson and others, "Iran," HSBC OCC 8874661-663. Mr. Moxley then outlined a new procedure that he advocated for

Mr. Moxley also stated that the position of his office in terms of processing the Iranian payments was becoming “increasingly untenable.” He wrote that HBEU Risk Management Services<sup>801</sup> would be controlling the new WOLF filter, but “we have been requested to find ways to circumnavigate our own and other institutions’ compliance filters.”<sup>802</sup> He described his role as protecting the bank from reputational risk, but “I now feel uncomfortable in compromising my position by leading IBL, PCM or Iranian counterparties down certain routes which may directly contravene the spirit of the Compliance framework.”<sup>803</sup> Mr. Moxley warned that, given the internal HBEU deadline to stop processing concealed Iranian transactions, beginning January 1, 2004, “no Iranian payments will be amended.”<sup>804</sup>

On November 11, 2003, HSBC Group Money Laundering Control Officer John Allison sent an email to HSBC Group AML head Susan Wright about his visit to HBEU’s Multicurrency Payments Department (MPD) the week prior to discuss Iranian payments.<sup>805</sup> He wrote that Iranian correspondent bank customers entered payment information on a form, and MPD staff were then expected to review the form to ensure the phrases “Iran,” “do not mention Iran,” or any other compromising reference were not included in the MT202 payment message transmitted to HBUS. He described this process as “established custom” rather than a documented procedure, “believed by MPD to be at the request of relationship management.” He also wrote that the new MPD Compliance manager was “not comfortable with the custom which he has inherited, neither from a moral compliance perspective, nor from the operational loss/embarrassment factor.” Mr. Allison also wrote that MPD Compliance is “very uncomfortable” about periodically being asked by Nigel Weir and Gary Boon in HBME whether a specific payment format will pass through an OFAC filter.<sup>806</sup> He stated that MPD Compliance viewed all of the Iranian payments they processed as meeting the requirements for a permissible U-turn transaction,<sup>807</sup> and wanted to move toward the legitimate execution of these payments in

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Iranian payments, the result of which would be that the Iranian banks would enter the payment information instead of HBEU.

<sup>801</sup> RMS was located within HBEU’s Payment Services. Subcommittee interview of Rod Moxley (6/7/2012).

<sup>802</sup> 10/24/2003 email from HBEU Rod Moxley to HBEU John Wilkinson and others, “Iran,” HSBC OCC 8874661-663.

<sup>803</sup> Id. at 662.

<sup>804</sup> Id..

<sup>805</sup> 11/11/2003 email from HSBC John Allison to HSBC Susan Wright, “Iran payments,” HSBC OCC 8877136-137.

<sup>806</sup> Id. at 136.

<sup>807</sup> Id. at 137. The email did not address the issue of whether Bank Markazi, as a government owned Central Bank, was unable to utilize the U-turn exception. Bank Markazi was added to the OFAC list in 2007.



light of what Mr. Root described as an “instruction” from Mr. Bagley “to cease processing Iranian bank payments.”<sup>808</sup>

On November 27, 2003, Mr. Moxley sent Ms. Wright a draft proposal to process Iranian U.S. dollar transactions. Although the proposal would prohibit altering a transaction document to remove the name of a prohibited country or town, and required a review for OFAC compliance, it did not require the transaction to include full payment details for the originator and ultimate beneficiary as outlined in the HBUS August 2001 U-turn payment procedure.<sup>809</sup>

On December 10, 2003, after having consulted HBUS Compliance head Carolyn Wind, Ms. Wright sent Mr. Moxley an email updating him on the Iranian U-turn payment proposal.<sup>810</sup> Ms. Wright indicated that the issue of processing payments through HBUS had been “discussed at length” among HBUS Compliance, outside legal counsel Tom Crocker, HBUS payments personnel, and HBEU during the summer of 2001. She indicated she had asked Ms. Wind to forward the 2001 HBUS proposal for consideration. The following day, Nigel Weir wrote to Ms. Wright that the HBUS proposal required a method for processing payments that was not HBME’s preferred solution.<sup>811</sup> He also expressed concern that HBEU would be unable to advise their customers of the proposed processing changes before the December 31 deadline and requested an extension. Ms. Wright forwarded the correspondence to Mr. Bagley.

On December 12, 2003, Mr. Bagley emailed Mr. Weir that if HBUS felt it could agree to processing the Iranian transactions only on the basis of fully transparent documentation, then its views would have to be taken into account. He also wrote that HBUS “must be comfortable” with the approach.

HBEU continued, however, to object to the new payment procedure. On December 18, 2003, HBEU wrote to HSBC Group Compliance that HBUS’ procedure, which it referred to as “the serial method,” “requires a large amount of work prior to commencement, a disproportionate amount of expense and a higher than average risk to the banks reputation being damaged by a future payment.”<sup>812</sup>

<sup>808</sup> Id. at 137. Although Mr. Root indicated that Mr. Bagley had ordered the MPD payments to “cease,” they continued for another two years.

<sup>809</sup> 11/27/2003 email from HBEU Rod Moxley to HSBC Susan Wright, “Draft Iranian – USD Payment Procedures,” HSBC OCC 8875225-232.

<sup>810</sup> 12/10/2003 email from HSBC Susan Wright to HBEU Rod Moxley and others, HSBC OCC 8875508.

<sup>811</sup> See 12/11/2003 email exchange between HSBC Susan Wright, HBME Nigel Weir, and others, “Iran – U-Turn Payments,” HSBC OCC 8877150-154.

<sup>812</sup> 12/18/2003 email from HBEU Tony Collins to HSBC John Allison and others, “Memo: Re: Iran – U-Turn Payments,” HSBC OCC 8873974-975. Group Compliance John Allison and John Root sought legal advice from outside counsel Tom Crocker of Alston & Bird and Mr. Crocker determined that “it is not clear that the cover payments meet the requirement of the U.S. Dollar

At the same time HBEU and HBUS were arguing over payment procedures, HBEU and HBME continued to send transactions involving Iran through their correspondent accounts at HBUS, the vast majority of which were undisclosed. A later analysis performed by an outside auditor at HBUS' request found that, in 2003, HSBC affiliates sent at least 5,400 Iranian transactions to U.S. dollar accounts in the United States, of which about 90% were not disclosed.<sup>813</sup>

Also in December, HBUS payments services head Denise Reilly spoke with HBUS' new AML Director Teresa Pesce, who began work in September 2003, about the Iranian issue and sent her a copy of the 2002 Eastwood memorandum describing how HBEU altered documentation and used cover payments to send U.S. dollar transactions involving Iran through their correspondent account at HBUS without HBUS' knowledge.<sup>814</sup> Ms. Reilly's email indicated that Ms. Pesce had also discussed the issue with Mr. Gallagher the previous day, although Mr. Gallagher told the Subcommittee he did not recall either seeing the memorandum or discussing it with Ms. Pesce.<sup>815</sup>

#### (e) Reaching Agreement

Despite the HBEU deadline announced by Rod Moxley, that MPD would stop processing concealed Iranian transactions after December 31, 2003, no agreement was reached by that date on how to process the transactions. Documents obtained by the Subcommittee indicate that HBEU did not adhere to its deadline, but continued to process Iranian transactions using cover payments and deleting any references to Iran in the payment instructions.

On March 10, 2004, after an Iranian transaction was detected and halted in London, HBEU MPD head Malcolm Eastwood wrote: "I remain extremely uncomfortable with the practice of amending Iranian payment orders for whatever means."<sup>816</sup> Mr. Eastwood advised HBEU Compliance and Institutional Banking to resolve the issue as soon as

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u-turn exception to the Regulations." 1/8/2004 memo from Thomas Crocker to John Root and John Allison, "Iranian U.S. Dollar U-Turn Transactions and Cover Payments," HSBC OCC 8903992-000.

<sup>813</sup> Deloitte presentation, "March 29, 2012," HSBC-PSI-PROD-0197919, at HSBC OCC 8966143. The Deloitte review examined HBEU and HBME Iranian transactions sent through U.S. dollar accounts at HBUS and other U.S. banks.

<sup>814</sup> See 12/17/2003 email from HBUS Denise Reilly to HBUS Teresa Pesce, "Compliance – OFAC Issues in General and Specific to Iran," HSBC OCC 3407517-522 ("Attached is the memo that we discussed yesterday in our meeting with Michael Gallagher."). See also 11/14/2002 memorandum from HBEU Malcolm Eastwood to HBUS Denise Reilly and HBEU Geoff Armstrong, "Compliance – OFAC Issues in General and Specific to Iran," HSBC OCC 7688824.

<sup>815</sup> Id. Subcommittee interview of Michael Gallagher (6/13/2012).

<sup>816</sup> 3/10/2004 email from HBEU Malcolm Eastwood to MDBK (Midland Bank) Quentin Aylward and others, "BankMarkazi Payment," HSBC OCC 8873979-980.

possible and remarked that his Compliance certificate is “heavily caveated to reflect that we are not compliant in respect of Iran.”<sup>817</sup> Mr. Eastwood sent a copy of his email to HSBC Group AML head Susan Wright who forwarded it to David Bagley.

The following day, Mr. Bagley responded to Mr. Eastwood by writing that he understood and shared his concerns, but believed his comments underestimated “the complexity of the OFAC regulation, and the competing competitive pressures across the Group.”<sup>818</sup> Mr. Bagley also wrote that one reason for the slow resolution was that “HBUS was unaware that any arrangements existed with Iranian banks.”

On March 22, 2004, more than two years after becoming head of HSBC Group Compliance, David Bagley confronted HBME Deputy Chairman David Hodgkinson about the need to change how HBME was handling U.S. dollar clearing activity for Iranian banks.<sup>819</sup> Mr. Bagley wrote that he was “uncomfortable with this activity in its current form,” and “the amount of revenue may not justify” the “additional work and investment” required, “nor would it justify ru[n]ning the reputational and regulatory risk in the US.” He expressed his willingness to discuss the issue further, but suggested “that any such conversation take place over the telephone, as we are seeking to avoid correspondence with HBUS on this sensitive issue other than through lawyers so as to preserve privilege.”<sup>820</sup>

**WOLF Filter Announced.** On March 23, 2004, HSBC Group issued a new Group Circular Letter 040021 implementing a major new initiative on “Payment screening.”<sup>821</sup> The circular announced that HSBC Group had developed an internal filter called “WOLF” to screen against terrorists and sanctioned countries and persons. The circular explained:

“As part of the international effort to combat terrorism, Competent Authorities in numerous countries have published lists of names that are known to be, or are believed to be involved in terrorist activity. ... In addition ... sanctions against a number of countries and names are imposed .... Compliance with these sanctions and orders has to date relied upon manual processes to identify when relevant names are contained in payment instructions. In order to ensure that compliance with the restrictions ... is achieved consistently across the Group, an automated payment screening

<sup>817</sup> Id. at 8873980.

<sup>818</sup> 3/11/2004 email from HSBC David Bagley to HBEU Malcolm Eastwood and others, “Bank Markazi Payment,” HSBC OCC 8873985-986.

<sup>819</sup> 3/22/2004 email from HSBC David Bagley to HBME David Hodgkinson and HSBC Warren Leaming, “Iran – Correspondent Banking Services,” HSBC OCC 8873995-997.

<sup>820</sup> Id.

<sup>821</sup> 3/23/2004 “GCL 040021: Payment screening,” prepared by HSBC Group, HSBC OCC 0953080-084.

utility named WOLF has been developed. When installed ... WOLF will, before execution, search all fields of a payment message for matches with listed terrorist/sanctioned names. Once a potential match with a word or words ... is identified, the unexecuted payments must be reviewed to establish whether the match is actually a true match, with appropriate action taken if it is. WOLF is the Group solution for real-time pre-execution payment screening.”<sup>822</sup>

The circular indicated that globally, WOLF would screen against terrorists listed by the United Nations, United States, United Kingdom, European Union, and Hong Kong, as well as countries or persons sanctioned by the United Nations. It indicated that compliance and payment operations personnel in HSBC affiliates were responsible for ensuring WOLF was loaded with other sanctioned names that were applicable locally.<sup>823</sup> It indicated that the screening would be applied first to international transactions, and later to domestic ones. The circular required affected HSBC entities to install the WOLF filter by the end of 2004.

**HBME Extension.** On April 17, 2004, HBME Deputy Chairman David Hodgkinson contacted David Bagley about the unresolved issues involving HBME’s U.S. dollar clearing business for Iran, because he anticipated having to explain HSBC’s position to the Central Bank during a visit to Tehran in May. Mr. Hodgkinson noted: “The current position as briefed to me last week was that we have not yet found a way to handle major USD clearing business.”<sup>824</sup> He informed Mr. Bagley that he had directed his staff to develop a proposal to undertake this business while minimizing risk, “so that if circumstances change we know our preferred way forward.”<sup>825</sup>

Mr. Bagley forwarded the email to his supervisor, HSBC Group legal counsel Richard Bennett. Mr. Bagley wrote: “[T]he most pressing issue to be resolved is that relating to the limited number of existing relationships that we have (for two small Iranian Banks) where I suspect that HBUS are not aware that payments may be passing through them. Do not believe that we can allow this situation to continue very much longer, which is the point I will make to David in my response.”<sup>826</sup>

<sup>822</sup> Id.

<sup>823</sup> Id. HSBC added the OFAC SDN list to the WOLF filter in 2004, and added the OFAC country list in August 2005. Subcommittee briefing by Cahill Gordon & Reindel LLP (6/20/2012).

<sup>824</sup> 4/17/2004 email from HBME David Hodgkinson to HSBC David Bagley and HSBC Warren Leaming, “Iran – Correspondent Banking Services,” HSBC OCC 8874671.

<sup>825</sup> Id. at 671.

<sup>826</sup> 4/19/2004 email from HSBC David Bagley to HSBC Richard Bennett, “Iran Correspondent Banking Services – OFAC,” HSBC OCC 8873994 and HSBC OCC 8966146. Mr. Bagley had allowed these payments to continue by granting a dispensation since they ran afoul of Group

This email is the third<sup>827</sup> in which Mr. Bagley indicated that HBUS might be unaware it was processing Iranian U-turn transactions that, in his own words, “may constitute a breach of U.S. sanctions,” yet contained no indication that Mr. Bagley planned to inform HBUS about the risks it was incurring.

Two days later, on April 19, 2004, Mr. Bagley again pressed HBME to resolve the issue. In an email to Mr. Hodgkinson, Mr. Bagley expressed concern about the correspondent relationships operating through HBME “which do not currently meet the requirement of the US Legal opinion that has now been obtained.”<sup>828</sup> He continued: “I have sanctioned the continuation of these services pending an early resolution of the way forward, but it is clear from your note that we are some distance away from finalizing our thinking such that we can go to HBUS with any proposal with regard to a way forward.” Mr. Bagley warned: “I feel that there is little option other than for me to recommend to HBEU that the existing activity be discontinued given the risk that we are posing for HBUS, unless the solution under consideration at your end gives us a satisfactory option.”

HBME’s Nigel Weir responded to Mr. Bagley’s email at the request of Mr. Hodgkinson, stating that he had already spoken with Gary Boon at HBME and John Allison at HSBC Group to develop a solution. He also requested that Mr. Bagley extend the dispensation from the HBEU decision to stop altering Iranian documentation until June 30, 2004.<sup>829</sup> Two days later, Mr. Bagley told John Allison that he was reluctant to extend the dispensation “unless there is a clear and agreed solution with a definite and proximate implementation date,” and requested an update the following week.<sup>830</sup> Despite Mr. Bagley’s indication that he would not grant an extension without an agreement, the same practices continued amid ongoing negotiations over the agreement’s provisions.

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policy. However, an increase in business, which is what HBME was seeking, was on hold pending an agreement between HBUS, HBEU, and HBME.

<sup>827</sup> The other two were a 10/21/2003 email from HSBC David Bagley to HBME Steve Banner, and others, “Iran-Strategy Discussion Paper,” HSBC OCC 8873946-947 (“I am not sure that HBUS are aware of the fact that HBEU are already providing clearing facilities for four Iranian banks, presumably including USD clearance.”); and a 3/11/2004 email from HSBC David Bagley to HBEU Malcolm Eastwood and others, “Bank Markazi Payment,” HSBC OCC 8873985-986 (“The complexity of the OFAC regulations, and the fact that HBUS were unaware that any arrangements existed with Iranian Banks, has made speedy resolution of this issue difficult.”).

<sup>828</sup> 4/19/2004 email from HSBC David Bagley to HBME David Hodgkinson, “Iran – Correspondent Banking Services,” HSBC OCC 8966135.

<sup>829</sup> 5/2/2004 email from HBME Nigel Weir to HSBC David Bagley and others, “Iran – Correspondent Banking Services,” HSBC OCC 8874673-674.

<sup>830</sup> 5/4/2004 email from HSBC David Bagley to HSBC John Allison, “Iran – Correspondent Banking Services,” HSBC OCC 8874673.

**Second Moxley Deadline.** About eight months after Mr. Moxley had raised strong objections to continuing to alter Iranian payments, no agreement had been reached among HSBC affiliates on increasing the transparency of the transactions. HBEU continued to delete references to Iran from the payment instructions, generate cover payments with incomplete payment information, and send undisclosed Iranian payments to HBUS. To break the impasse, in June 2004, outside legal counsel in the United States proposed a new payments solution, which essentially required that all U-turns be processed by HBUS in a transparent or “serial” manner that identified the underlying originators and beneficiaries.

On June 9, 2004, HBEU senior payments official Rod Moxley reacted negatively to the proposal due to operational difficulties. At the same time, he wrote: “I feel very uncomfortable recommending that we continue to process Iranian payments.”<sup>831</sup> He requested a formal response by June 18, 2004, and stated that “unless compelling commercial reasons” approved by HSBC Group Compliance and HBUS exist, he would stop handling Iranian payments after September 30, 2004.<sup>832</sup> This email represented his second attempt to cut off Iranian payments that MPD was uncomfortable processing.

On June 30, 2004, Nigel Weir wrote to Mr. Moxley and asked him to revisit the issue and work with HSBC Group Compliance on a solution enabling HBEU to execute U.S. dollar payments for Iranian banks in accordance with U.S. regulations.<sup>833</sup> Mr. Weir told Mr. Moxley that if the payments were stopped, “we will be effectively insulting the Government and State of Iran.” Mr. Weir stated that the bank had declined new U.S. dollar payment business from Iranian banks due to the sensitive political situation, “but to exit business which we have been conducting for many years would jeopardize all other existing business activities.” He estimated that the Group profit from existing Iranian business activities amounted to \$10 million per year.

Also on June 30, 2004, HBME Deputy Chairman David Hodgkinson forwarded the correspondence between Mr. Moxley and Mr. Weir to then HBEU CEO Michael Geoghegan, asking for his “intervention and support” in positively resolving the long-standing issue, and noting Iran’s “significant strategic importance” to the Group.<sup>834</sup> Mr. Hodgkinson also noted that the volume of Iranian payments was small at 20 per day. When asked about this email, Mr.

<sup>831</sup> 6/9/2004 email from HBEU Rod Moxley to HSBC John Allison and others, “Iran,” HSBC OCC 8874002-004.

<sup>832</sup> Id.

<sup>833</sup> 6/30/2004 email from HBME Nigel Weir to HBEU Rod Moxley and others, “Memo: Re: Iran,” HSBC OCC 8874001-002.

<sup>834</sup> 6/30/2004 email from HBME David Hodgkinson to HBEU Michael Geoghegan, “Memo: Re: Iran,” HSBC OCC 8874001.

Moxley told the Subcommittee that it resulted in HBEU and HBME's obtaining a "dispensation" from having to end the alteration of Iranian transactions until the end of 2004.<sup>835</sup> When asked about the dispensation approval process, he said that he thought that HSBC Group Compliance approval was needed along with secondary approval from either HSBC Group Audit or another manager.

Later that day, another HBEU official John Ranaldi sent an email to Mr. Geoghegan stating that he was aware of the Iranian situation and would get an update. He wrote: "[B]asically, our interpretation was that we were being asked to 'fudge' the nature of the payments to avoid the U.S. embargo and seizure."<sup>836</sup> When asked about this email, Mr. Geoghegan told the Subcommittee that he could not explain what Mr. Ranaldi meant by using the word "fudge," except that it related to Iran.<sup>837</sup> He said that, at the time, he was unaware that HBEU was altering transaction documentation or using cover payments. Having since learned what was going on, he told the Subcommittee that he assumed that's what Mr. Ranaldi was talking about. When asked whether it raised alarm bells at the time, he remarked that he got many emails and Mr. Ranaldi used colorful language. He said that he also knew Mr. Ranaldi would follow-up with him in a few days.

**HBEU Proposal.** On July 6, 2004, HBEU's Rod Moxley produced a specific proposal as a potential way forward using his preferred solution of serial payments.<sup>838</sup> The extensive proposal also shed light on existing practices at HBEU.<sup>839</sup>

The proposal noted that HBEU had been trying to come up with a solution for two years after an HBEU compliance officer challenged the practice of altering Iranian payment instructions in June 2002. It noted that Bank Mellī, Bank Markazi, Bank Tejarat, Bank Kesharvazi, and the Export Development Bank of Iran were the five Iranian financial institutions that took advantage of this practice to effect U.S. dollar payments with a daily volume estimated at between 10 and 50 payments per day at an approximate total value of \$500,000 to \$1 million. The proposal also noted that the Central Bank payments were much larger, in the range of \$10 million, and were typically made at certain times of the

<sup>835</sup> Subcommittee interview of Rod Moxley (6/7/2012).

<sup>836</sup> 6/30/2004 email from HBEU John Ranaldi to HBEU Michael Geoghegan, "Memo: Re: Fw: Iran," HSBC OCC 8873999.

<sup>837</sup> Subcommittee interview of Michael Geoghegan (5/24/2012).

<sup>838</sup> See 7/2004 discussion paper, "HSBC Bank PLC Iranian Payment Processing Proposals," HSBC OCC 8874026-034.

<sup>839</sup> Id. For example, according to the document, the existing HBEU practice was that if an Iranian financial institution included a cautionary statement, such as "Do not mention Iran," in Field 72 of the payment instructions, the payment would drop out to what was called a repair queue. Once in the repair queue, HSBC personnel would alter the payment instructions by deleting any reference to Iran.

month.<sup>840</sup> The proposal stated that the “vast majority of payments are valid, falling within the U-turn exception.”<sup>841</sup>

The proposal discussed two potential payment options that would meet HBUS’ requirement for transparency. It noted that HBEU preferred the “serial payment” option which would allow the Iranian banks to format their payments in a way that would not require intervention from HBEU. HBEU believed this aspect of the proposal would relieve it of any responsibility to review the payments, leaving it up to HBUS, or another U.S. bank where a payment was directed, to verify that the payment met the U-turn exception requirements. The proposal indicated that HBEU would continue to utilize WOLF and other filters to screen the payments, but the Iranian financial institutions would be responsible for ensuring they submitted only valid U-turn payments “permissible under the terms of US legislation.” The proposal indicated this solution would also transfer the risks associated with blocked payments to the Iranian banks.<sup>842</sup> The proposal acknowledged that HBUS would need to agree to this solution, and HBEU and Group Compliance would need to “sign-off” on it prior to moving forward.

On July 6, 2004, HBEU MPD head Malcolm Eastwood forwarded Mr. Moxley’s proposal to John Ranaldi, noting that he continued to have serious concerns about the Iranian U.S. dollar clearing business.<sup>843</sup> Mr. Ranaldi forwarded the email to then HBEU CEO Michael Geoghegan, writing: “reference your earlier query.”<sup>844</sup> According to Mr. Ranaldi, Mr. Eastwood’s department was being asked to “amend instructions or assume responsibility that the contents of the payment message do not attract the Fed’s attention and seize the payment.” He explained that a “payment clerk is asked to judge upon a payment kicked out by the filtering system, whether to release, or return.” He wrote, “there is an irony; someone could argue that by returning payments to Iran that we are contravening the ofac rules.”<sup>845</sup> Mr. Ranaldi characterized the risks associated with the existing practice as including operational losses due to payment seizure, threats to HSBC’s reputation, and “incurring hefty fines.” He told Mr. Geoghegan that Lloyds Bank had been fined “and few if any u.k. banks are in the business.”

When asked about this email, Mr. Geoghegan told the Subcommittee that he was “puzzled” that he didn’t act to stop the

<sup>840</sup> 7/2004 discussion paper, “HSBC Bank PLC Iranian Payment Processing Proposals,” HSBC OCC 8874026-034.

<sup>841</sup> Id.

<sup>842</sup> Id. at 030.

<sup>843</sup> 7/6/2004 email from HBEU Malcolm Eastwood to HBEU John Ranaldi and others, “HBEU Iranian Payments Business,” HSBC OCC 8876861

<sup>844</sup> Id.

<sup>845</sup> 7/6/2004 email from HBEU John Ranaldi to HBEU Michael Geoghegan, “HBEU Iranian Payments Business,” HSBC OCC 8876861.



practice immediately or get out of the business. He remarked that he did respond that way with Mexico, so thought it was odd that he didn't in this case. He couldn't recall whether he talked to any other senior HSBC Group executives about the issue.<sup>846</sup>

Emails in early August 2004 show HBEU and HBME reviewing and discussing the Moxley proposal.<sup>847</sup> On August 6, 2004, Mr. Bagley commented: "My initial reaction is that the proposals are more robust, and therefore more likely to be acceptable that we originally contemplated or proposed."<sup>848</sup> He also said the proposal had to be sent to HBUS' outside legal counsel for confirmation it would meet OFAC requirements.<sup>849</sup> Later that day, the HSBC Global head of Payments and Cash Management, Iain Stewart, forwarded Mr. Bagley's email to Mr. Geoghegan and Mr. Hodgkinson with a note: "Progress report. This will delay it a bit but we are getting there."<sup>850</sup> When asked about this email, Mr. Geoghegan surmised that HBUS was involved and legal opinions were being obtained.<sup>851</sup>

On September 22, 2004, HBEU Nigel White informed Mr. Stewart and others, including Mr. Bagley, that "all involved parties have signed off on the proposal," and the next step was for HSBC Group Compliance to obtain agreement from HBUS.<sup>852</sup> At the same time these negotiations were ongoing, HBEU and HBME continued to send undisclosed Iranian transactions to HBUS with the tacit approval of HSBC Group Compliance.

**HBUS Approval.** The revised Moxley proposal was sent to HBUS in November 2004. On November 30, 2004, HBUS' AML Director Terry Pesce, PCM head Michael Gallagher, and Payment Services head Denise Reilly met with HBUS CEO Martin Glynn, about HBUS processing U-turn transactions. Prior to the meeting, Ms. Reilly circulated the HBUS procedures that were developed in 2001, "when the topic was last active."<sup>853</sup> The internal emails suggest that one HBUS employee may have been under the impression that the processing of Iranian transactions had not yet begun and did not know that HBUS had

<sup>846</sup> Subcommittee interview of Michael Geoghegan (5/24/2012).

<sup>847</sup> See 8/4/2004 email exchanges among MDBK Phil Baines to HBEU Nigel White and others, "Iranian – Payment Processing Proposals," HSBC OCC 8874705-708.

<sup>848</sup> 8/6/2004 email from HSBC David Bagley to HBEU Nigel White and others, "Iranian – Payment Processing Proposals," HSBC OCC 8874703-704.

<sup>849</sup> Id.

<sup>850</sup> 8/6/2004 email from HSBC Iain Stewart to HBEU Michael Geoghegan and HBME David Hodgkinson, "Iranian – Payment Processing Proposals," HSBC OCC 8874703.

<sup>851</sup> Subcommittee interview of Michael Geoghegan (5/24/2012).

<sup>852</sup> 9/22/2004 email from HBEU Nigel White to HSBC Iain Stewart and others, "Iranian U Turn Payments," HSBC OCC 8874023-034.

<sup>853</sup> 11/30/2004 email from HBUS Denise Reilly to HBUS Sandra Peterson and HBUS Michael Gallagher, "U-turns," HSBC-PSI-PROD-0096166; 11/29/2004 email from HBUS Denise Reilly to HBUS Michael Gallagher and others, "U-turns," HSBC-PSI-PROD-0096167.

already been processing Iranian U.S. dollar transactions for at least three years.<sup>854</sup>

A few days after the high level meeting among HBUS officials, Ms. Reilly sent Mr. Gallagher a description of “the conditions under which HBUS will accept U-Turn transactions.”<sup>855</sup> Those conditions included that transactions would be formatted to be fully transparent serial payments; HBEU would agree not to alter payment instructions and abide by the U-turn processing requirements; HBUS would not be liable for penalties resulting from OFAC sanction violations; a separate “HBEU Special Account” would be established at HBUS to handle Iranian originated transactions and the account number would be added to the HBUS OFAC filter so all transactions could be reviewed and approved prior to processing; HBUS would be reimbursed for the additional employees needed to handle review of these payments; and fees for the transactions would reflect the processes and risk.<sup>856</sup> Whereas the 2001 protocol was specific to Bank Melli, this protocol applied to all Iranian transactions.<sup>857</sup>

On December 15, 2004, Mr. Bagley informed the HSBC Global Head of PCM Marilyn Spearing and HBME Deputy Chairman David Hodgkinson that he had advised then HSBC Group CEO Stephen Green “that a compliant solution had been agreed in principle with HBUS.” While this agreement was a significant milestone, Mr. Bagley said Mr. Green wanted to consider the issue and possibly discuss it with then HSBC Group Chairman John Bond.

Mr. Bagley asked Ms. Spearing to provide him data on the potential commercial value of the Iranian U.S. dollar transactions to the Group, considering both existing and future business. He wrote:

“I would not suggest that we seek to try and influence the debate at this stage....but it might be helpful if I was armed with the likely value to the Group if we are in effect making a reputational risk over possible reward type judgment.”<sup>858</sup>

<sup>854</sup> See, e.g., 11/30/2004 email from HBUS Sandra Peterson to HBUS Denise Reilly and HBUS Michael Gallagher, “U-turns,” HSBC-PSI-PROD-0096165 (Ms. Peterson: “Is this proposal for Bank Melli only or is the intent to grow this business? When this topic first arose it was to support Bank Melli but my understanding is that the business under discussion now is more general, with no specific clients named to date.”).

<sup>855</sup> 12/2/2004 email from HBUS Denise Reilly to HBUS Michael Gallagher and others, “U-Turns,” HSBC OCC 3407526-527.

<sup>856</sup> Id. at 527.

<sup>857</sup> Subcommittee meeting with HSBC legal counsel (4/12/12).

<sup>858</sup> 12/15/2004 email from HSBC David Bagley to HSBC Marilyn Spearing and HBME David Hodgkinson, “Iran – OFAC,” HSBC OCC 8874039.

Mr. Bagley concluded by writing that it would probably be “sensible” to “gently” proceed “assuming that we may get sign-off.”<sup>859</sup>

An internal OCC memorandum indicates that, in early 2005, HBUS contacted the OCC about a proposal to process Iranian U-turns.<sup>860</sup> In the memorandum, an OCC examiner described how legitimate U-turns could be processed and wrote: “[W]e notified Ms. Pesce that we believed the transactions to be permissible. However, we also informed her that the bank would have to maintain extremely tight controls over the transactions as well as a comprehensive system of controls for monitoring purposes.”<sup>861</sup> Later in the same memorandum, the OCC examiner wrote: “[O]n February 23, 2005 Ms. Pesce informed the writer that the decision to process the u-turn transactions was not to go forward and that the area business had made the decision not to undertake such processing.”<sup>862</sup>

The documentation suggests that even after reaching agreement with HBUS on how to process Iranian transactions, HBEU and HBME continued to send undisclosed Iranian transactions through their HBUS accounts. A later analysis performed by an outside auditor at HBUS’ request found that HSBC affiliates sent about 7,800 Iranian transactions through U.S. dollar accounts in the United States during 2004, of which more than 90% continued to be undisclosed.<sup>863</sup>

#### (f) Processing the Iranian Transactions

The 2004 agreement reached among HSBC affiliates on how to process Iranian U-turn transactions did not end the controversies or new developments affecting those transfers.

**Considering an Exit.** Four months after agreement was reached with HBUS on how to process Iranian transactions, on April 8, 2005, David Bagley reached out to Mr. Hodgkinson to request an assessment of the nature and extent of Iranian business for an analysis Mr. Bagley was asked to prepare for the HSBC Group Chairman. It appears that at the top levels of HSBC, there was some discussion about exiting the Iranian business entirely due to a “specific transaction for NPC” about which Mr. Bagley had spoken with Mr. Green.<sup>864</sup> In the same email, Mr. Bagley wrote, “This is needed partly as part of the risk over reward

<sup>859</sup> Id. at 039.

<sup>860</sup> See 2/28/2005 OCC memorandum, “Issues Update,” OCC-PSI-00903648-650, at 2. [Sealed Exhibit.]

<sup>861</sup> Id.

<sup>862</sup> Id.

<sup>863</sup> Deloitte presentation, “March 29, 2012,” HSBC-PSI-PROD-0197919, at HSBC OCC 8966143. The Deloitte review examined HBEU and HBME Iranian transactions sent through U.S. dollar accounts at HBUS and other U.S. banks.

<sup>864</sup> 4/8/2005 email from HSBC David Bagley to HBME David Hodgkinson and HBME Nasser Homapour, “Iranian Business – OFAC,” HSBC OCC 8874052. The reference to NPC is unclear.

equation, but also because we will need to both analyze each different type of business and assess how we will deal with legacy issues.”<sup>865</sup> He continued: “It is not all as bad as it seems as the conversation today gave some clear possible alternative approaches to an outright ban.”<sup>866</sup>

Two days later, on April 10, 2005, HBME official Ajay Bhandoola provided Mr. Bagley with a paper discussing payment alternatives for Iran.<sup>867</sup> The paper laid out two proposals for continuing payments from Iranian bank accounts with HSBC “to protect our Iranian franchise while minimizing any possible legal, regulatory or reputational risk to HBUS.” The two alternative solutions provided were to use another U.S. dollar correspondent (other than HBUS) for HBME, and to limit U.S. dollar accounts for Iranian banks to specific purposes.<sup>868</sup> HBME did not explain why it was considering using a third party correspondent since HBUS had already agreed to process the Iranian transactions using transparent procedures.<sup>869</sup>

**Stopping Payments.** On April 19, 2005, HBUS’ OFAC filter stopped a \$362,000 payment from Bank Melli because it contained the phrase “do not mention our name in New York.”<sup>870</sup> When asked in general about why payments would be stopped in the HBUS filter, Rod Moxley told the Subcommittee that messages like the one mentioned above should have been deleted in the processing area but was errantly left on the outgoing instructions.<sup>871</sup> This incident indicated that HBEU’s MPD was still altering Iranian payment instructions in April 2005, one year after Mr. Moxley had threatened to stop processing all payments if forced to continue altering them, and four months after HBEU and HBUS reached agreement on using fully transparent Iranian U.S. dollar transactions. HBEU resubmitted the payment on April 22, 2005, but HBUS stopped it again and sent a SWIFT message requesting full disclosure of the name and address of the underlying originator and ultimate beneficiary. Two follow-up requests were sent by HBUS on April 28 and May 4, 2005. As of May 5, 2005, no response had been received.<sup>872</sup>

In early May 2005, a \$6.9 million wire payment involving Iran was also stopped by HBUS because the payment details included the phrase,

<sup>865</sup> Id.

<sup>866</sup> Id.

<sup>867</sup> 4/10/2005 email from HBME Ajay Bhandoola to HSBC David Bagley and others, “Iranian Business – OFAC,” HSBC OCC 8874051-057.

<sup>868</sup> Undated “Iranian Accounts and USD Payments,” prepared by HBEU, HSBC OCC 8874055-057.

<sup>869</sup> Id. at 056-057.

<sup>870</sup> 5/5/2005 email from HBUS Elizabeth Protomastro to HSBC John Allison and others, “Payment rejected re Melli Bank PLC – USD 362,000,” HSBC-PSI-PROD-0096170-171.

<sup>871</sup> Subcommittee interview of Rod Moxley (6/7/2012).

<sup>872</sup> 5/5/2005 email from HBUS Elizabeth Protomastro to HSBC John Allison and others, “Payment rejected re Melli Bank PLC – USD 362,000,” HSBC-PSI-PROD-0096170-171.

“Bank Melli Iran.”<sup>873</sup> HBUS OFAC Compliance officer Elizabeth Protomastro sent an email to HBEU, as well as HSBC Group, stating:

“Though the payment appears to meet the U-turn under the Iranian Transactions Regulations, we require that the payments should be fully disclosed as to the originator and beneficiary information before processing. We know that this policy is in line with the stance of other U.S. financial institutions .... You are also aware, from past discussions, that this is required by HBUS.

Let us know if you have any questions. Please advise on your side of the delay in processing.”<sup>874</sup>

The email chain regarding the stopped payment was forwarded to Mr. Bagley, who then contacted HBUS AML head Teresa Pesce to ask whether HBUS’ action “denotes a change of policy and approach within HBUS to what I would normally expect to be cover payments.”<sup>875</sup> Mr. Bagley wrote:

“As you are aware, there are no Group standards which require that the originator and beneficiary details go in all payments. Accordingly, Group Operation globally will not habitually require or input this information if the underlying customer instruction is received on a basis permitted by the SWIFT format and by local regulation.”

He noted that if the payment were suspended due to a reference to Iran, he understood. But if the action taken by HBUS denoted a change of policy on what information had to be included in payment instructions, that change may not have been communicated across the Group and vetted with business colleagues. This email was sent in 2005, by Mr. Bagley, after more than two years of negotiations to increase transparency with regard to Iranian transactions.

Ms. Pesce forwarded Mr. Bagley’s email to HBUS OFAC Compliance officer Elizabeth Protomastro and senior HBUS Compliance official Anne Liddy. Ms. Protomastro responded that “for the most part” the U-turns being processed by HBUS for HBEU had been fully disclosed in compliance with the conditions specified in December 2004.<sup>876</sup> Ms. Protomastro stated that the remitter involved in

<sup>873</sup> 5/3/2005 email from HBUS Elizabeth Protomastro to HSBC John Allison, HSBC Susan Wright, HBEU Rod Moxley, and others, “Wire payment suspended re ‘Iran’ – USD 6,912,607.82,” HSBC OCC 8874710-712, at 711.

<sup>874</sup> Id. at 712.

<sup>875</sup> 5/4/2005 email from HSBC David Bagley to HBUS Teresa Pesce, “Wire Payments Suspended,” HSBC OCC 8874710-711.

<sup>876</sup> 5/4/2005 email from HBUS Elizabeth Protomastro to HBUS Teresa Pesce and others, “Wire Payments Suspended,” HSBC OCC 8874710.

the \$6.9 million transfer was Credit Suisse Zurich, which was “well aware of the u-turn practices of other U.S. organizations and the requirement for full disclosure of the name and address of the originator and the beneficiary.”<sup>877</sup>

On June 3, 2005, Ms. Protomastro informed HSBC Group about two more HBEU transfers, for \$1.9 million and \$160,000, that had been stopped by HBUS due to the lack of full disclosure of the originator, beneficiary, and purpose of the payment.<sup>878</sup> HBEU responded that both payments were foreign exchange related, the originators were Bank Tejarat and Bank Melli, and the beneficiaries were Persia International Bank and Credit Suisse Zurich, respectively.<sup>879</sup> Ms. Protomastro responded by requesting that HBEU follow up with the banks to obtain the names and addresses of the initial originators and ultimate beneficiaries, as well as confirmation of the underlying purpose of the payments, in accordance with the “agreement reached in the past” between HBUS and HBEU requiring full disclosure for U-turn payments.<sup>880</sup> According to information provided by Bank Melli through HBEU, the \$160,000 payment denoted an internal transfer from Bank Melli’s account with HBEU to Bank Melli’s account with Credit Suisse Zurich.<sup>881</sup> This information allowed the payment to be released.<sup>882</sup> Mr. Marsden stated that he was in the process of contacting Bank Tejarat for additional information about the \$1.9 million transfer.

On June 6, 2005, Anne Liddy sent HBUS AML head Teresa Pesce the email correspondence about the two Iranian payments that had been suspended.<sup>883</sup> She also informed Ms. Pesce that 44 of the approximately 60 payments stopped by the HBUS OFAC filter the previous month, May 2005, and forwarded for review, referenced Iran. She remarked that this was “quite a lot.” The following day, HBUS OFAC Compliance officer Grace Santiago-Darvish informed HBUS’ Payment Services head Denise Reilly that they would be sending a message to all

<sup>877</sup> Id.

<sup>878</sup> 6/3/2005 email between HBUS Elizabeth Protomastro and HSBC John Allison and others, “Wire payments from HSBC Bank PLC suspended – USD 1,900,000 and USD 160,000 (Iran),” HSBC OCC 3407547.

<sup>879</sup> 6/6/2005 email from HBEU Rod Moxley to HBUS Elizabeth Protomastro and others, “Re: Wire payments from HSBC Bank PLC suspended – USD 1,900,000 and USD 160,000 (Iran),” HSBC OCC 3407546-547.

<sup>880</sup> 6/6/2005 email from HBUS Elizabeth Protomastro to HBEU Stephen Cooper and others, “Re: Wire payments from HSBC Bank PLC suspended – USD 1,900,000 and USD 160,000 (Iran),” HSBC OCC 3407544-545.

<sup>881</sup> 6/7/2005 email from HBEU Anthony Marsden to HBUS Grace Santiago-Darvish, “Re: Wire payments from HSBC Bank PLC suspended – USD 1,900,000 and USD 160,000 (Iran),” HSBC OCC 3407543-544.

<sup>882</sup> 6/7/2005 email from HBEU Anthony Marsden to HBEU Rod Moxley and others, “Re: Wire payments from HSBC Bank PLC suspended – USD 1,900,000 and USD 160,000 (Iran),” HSBC OCC 3407544-545.

<sup>883</sup> 6/6/2005 email from HBUS Anne Liddy to HBUS Teresa Pesce and others, “Fw: Wire payments from HSBC Bank PLC suspended – USD 1,900,000 and USD 160,000 (Iran),” HSBC OCC 3407537.

HSBC locations to remind them about the need to fully disclose underlying information in U-turn payments. She wrote: “We, in Compliance have noticed that, other locations could be more forthcoming about disclosing orig[inator], and bene[fi]ciary information.”<sup>884</sup>

**Switch from HBEU to HBME.** On May 20, 2005, HBME Deputy Chairman David Hodgkinson sent an email to HSBC business heads that, after a meeting with the HSBC Group Chairman and Group CEO, a decision had been made to transfer all Iranian bank U.S. dollar accounts held by HBEU to HBME, and utilize a “third party correspondent in the US for cover and other valid U turn payments.”<sup>885</sup> When asked about this decision, David Bagley told the Subcommittee that the processing of the payments was moved to HBME because that was where the locus of business was located.<sup>886</sup> In addition, HBME set up a special team to review the transactions to ensure consistent treatment. Mr. Hodgkinson also informed HSBC business heads that they should suspend new business and the expansion of current activities with Iran until the political situation improved, but that “existing business and commitments with Iran” were allowed to continue.<sup>887</sup>

**JP Morgan Chase.** On June 20, 2005, David Bagley informed David Hodgkinson that Iranian payments had been discussed in a meeting he had with HSBC Group CEO Stephen Green and HSBC Group legal counsel Richard Bennett.<sup>888</sup> He wrote that it was decided that all U-turns, whether passing through HBUS or another U.S. correspondent, would have to comply with the U-turn requirements in OFAC regulations. He wrote that Mr. Green also wanted confirmation that the “agreed arrangements in relation to Iranian payments had been put in place,” and that payments, including any cover payments, passing through the United States would comply with OFAC regulations. Mr. Bagley wrote:

“Although I may have misunderstood our discussions I was not previously aware that this was a precondition nor did my original paper envisage that if we used a non-Group correspondent we would necessarily consider passing only U-turn exempt payments through them. In fact in such circumstances there would be no reason to use

<sup>884</sup> 6/7/2005 email from HBUS Grace Santiago-Darvish to HBUS Denise Reilly and others, “Re: Wire payments from HSBC Bank PLC suspended – USD 1,900,000 and USD 160,000 (Iran),” HSBC OCC 3407536.

<sup>885</sup> 5/20/2005 email from HBME David Hodgkinson to HBME Nasser Homapour and others, “Iran,” HSBC OCC 8874714.

<sup>886</sup> Subcommittee interview of David Bagley (4/12/2012).

<sup>887</sup> 5/20/2005 email from HBME David Hodgkinson to HBME Nasser Homapour and others, “Iran,” HSBC OCC 8874714.

<sup>888</sup> 6/20/2005 email from HSBC David Bagley to HBME David Hodgkinson, “Iranian Payments,” HSBC OCC 8878027-029.

anyone other than HBUS given that HBUS could not be criticized were it to carry out exempt payments.”<sup>889</sup>

Mr. Bagley’s comments suggest that he was under the impression that using a non-Group correspondent would have allowed HSBC to process Iranian payments that did not meet the U-turn exception. However, after his discussion with Mr. Bennett and Mr. Green, he requested that Mr. Hodgkinson confirm they would be sending only compliant U-turn transactions through the United States, regardless of “whether or not through our own correspondent.”<sup>890</sup>

On June 27, 2005, David Hodgkinson responded that HBME was attempting to open a U.S. dollar correspondent account with JPMorgan Chase (JPMC) for the purpose of processing Iranian U.S. dollar payments. Later in the email he wrote: “we never envisaged anything other than U-Turn compliant payments being processed,” and confirmed agreement that “there is no reason to use anyone other than HBUS.” He clarified that the only reason they had considered another U.S. correspondent for these payments was due to HBUS being unwilling to process them for reputational risk reasons.<sup>891</sup> When Michael Gallagher, the head of HBUS PCM, was asked whether he was aware that HBME opened a U.S. dollar account with JPMorgan Chase in 2005, he could not recall.<sup>892</sup> He further explained that HBME must have thought that HBUS’ standards were higher if they went to JPMorgan Chase to do the same service.

Despite that email, HBME did open a U.S. correspondent account with JPMC. Mr. Bagley alerted HSBC Group CEO Stephen Green to the account on September 19, 2005, writing that HBME had opened a correspondent account with JPMC “through which the pre-screened compliant U-turn Iranian Payments can be made.”<sup>893</sup> A later analysis conducted by an outside auditor at HBUS’ request found that HBME

<sup>889</sup> Id.

<sup>890</sup> Id. at 8878028. With regard to cover payments, Mr. Bagley wrote that failing to consider an entire transaction (“both the cover payment instruction and any linked bank to bank message”), which if considered together “would lead to a different determination in terms of that U-turn exemption,” needed to be included in the risk determination. Mr. Bagley also referenced heightened concerns about the level of scrutiny from U.S. authorities regarding cover payments and OFAC compliance by “US banks offering correspondent banking services,” stemming from discussions held at a recent Wolfsberg meeting. The Wolfsberg Group consists of major international banks that meet regularly and work together to combat money laundering. See <http://www.wolfsberg-principles.com/index.html>.

<sup>891</sup> 6/27/2005 email from HBME David Hodgkinson to HSBC David Bagley and HSBC Richard Bennett, “Iranian Payments,” HSBC OCC 8878026-027.

<sup>892</sup> Subcommittee interview for Michael Gallagher (6/13/2013).

<sup>893</sup> 9/19/2005 email from HSBC David Bagley to HSBC Stephen Green and HSBC Richard Bennett, “GCL050047 “Compliance With Sanctions,” HSBC OCC 8874360-361.



sent about 1,800 U-turns to its JPMorgan Chase account in 2005 and 2006.<sup>894</sup>

### (g) Establishing Group-wide Policy

In July 2005, HSBC Group Compliance issued a Group Circular Letter (GCL) that for the first time established Group-wide policy on processing OFAC sensitive transactions, including U-turns involving Iran. GCL 050047 explicitly barred all HSBC affiliates and offices from participating in any U.S. dollar transaction, payment, or activity that would be prohibited by OFAC regulations.<sup>895</sup> The GCL also explicitly acknowledged the U-turn transactions permitted under OFAC regulations and required all compliant U-turn transactions be routed through an HBME “Center of Excellence” in Dubai for processing. While the policy directed all HSBC affiliates to use only permissible Iranian U-turns, the GCL also allowed HSBC affiliates to continue to use cover payments when sending them through U.S. accounts for processing, which meant the transactions would continue to circumvent the OFAC filter and any individualized review by the recipient U.S. bank, including HBUS.<sup>896</sup>

The 2005 GCL also required local U.S. dollar clearing systems, located in Hong Kong and the United Arab Emirates, to implement WOLF screening for all U.S. dollar payments to ensure that non-compliant payments were rejected. The GCL stated: “Any dispensation from the terms of this GCL requires GHQ CMP [Group Compliance] concurrence.”<sup>897</sup> Mr. Bagley described the GCL as being “necessary and urgent to protect the Group’s reputation.”<sup>898</sup>

About a month after the GCL was issued, the HSBC Group head of Global Institutional Banking, Mark Smith, issued a managerial letter, in August 2005, providing guidance on implementing the new policy.<sup>899</sup> The letter provided a brief summary of Group’s relationship with each of

<sup>894</sup> Subcommittee briefing by Cahill Gordon & Reindel LLP (6/20/2012); Deloitte presentation, “March 29, 2012,” HSBC-PSI-PROD-0197919, at HSBC OCC 8966143. The Deloitte review examined HBEU and HBME Iranian transactions sent through U.S. dollar accounts at HBUS and other U.S. banks.

<sup>895</sup> See 7/28/2005 GCL 050047, “Compliance with Sanctions,” HSBC OCC 3407560-561.

<sup>896</sup> Id.

<sup>897</sup> Id.

<sup>898</sup> 7/26/2005 email from HSBC David Bagley to HSBC Mansour Albosaily and others, “OFAC GCL,” HSBC OCC 3407550-555. Upon receipt of the GCL, on July 26, 2005, Anne Liddy wrote that she would discuss the need for OFAC training with John Allison and Susan Wright at their monthly meeting the following day to ensure HBEU and HBME “clearly understand OFAC” and “how to identify a true U turn.” 7/26/2005 email from HBUS Anne Liddy to HBUS Grace Santiago-Darvish and others, “OFAC GCL,” HSBC OCC 3407549.

<sup>899</sup> 8/25/2005 managerial letter from HSBC Mark Smith to HBUS Aimee Sentmat, HBME Alan Kerr, and others, “GCL050047 – Compliance with OFAC sanctions,” HSBC OCC 3407565-569.

the OFAC sanctioned countries.<sup>900</sup> With respect to Iran, Mr. Smith wrote: “Iran – extensive relationships with a number of Iranian institutions. Group Compliance had re-affirmed that OFAC sanctions, including the U-turn exception, apply to all transactions.”<sup>901</sup> The guidance also clarified that the revised policy applied only to U.S. dollar transactions and continued to permit non-U.S. dollar business with prohibited countries and persons on the OFAC list.<sup>902</sup>

Also in August 2005, HBUS circulated an email identifying correspondent relationships affected by the new policy.<sup>903</sup> The email identified the number of open correspondent accounts with financial institutions in affected countries, including Iran. It also explained:

“The revised policy does not represent an automatic exit strategy with regards to affected clients. Non-USD business (and for Iran, U-turn exempt transactions) may continue to be undertaken. ... Verbal discussions with affected clients would be preferable. Any written correspondent seeking to clarify the Group’s revised policy should be cleared with local Compliance.”<sup>904</sup>

Once the policy was in place, HSBC personnel took a closer look at some of the Iranian transactions. On August 10, 2005, HBME sales manager Gary Boon sent John Root an email which included an excerpt from an email sent by David Bagley to David Hodgkinson.<sup>905</sup> In it, Mr. Bagley noted that Mr. Hodgkinson had conveyed that a “significant number” of the trade and other transactions involving HBME would be U-turn compliant. In response, Mr. Bagley wrote: “I have to say that a number of potential payments resulting from trade transactions from other Group offices that John Root and I have looked at since the issuance of the GCL are not in our view U-turn compliant.”

In September 2005, HBEU senior payments official Rod Moxley completed an analysis of U.K. transactions over a ten day period that were stopped by the HSBC WOLF filter and involved prohibited countries, including Iran.<sup>906</sup> He forwarded the results to senior HSBC

<sup>900</sup> 8/25/2005 Managerial Letter from Mark Smith, “GCL050047 – Compliance with OFAC sanctions,” HSBC OCC 3407565-569.

<sup>901</sup> Id. at 568.

<sup>902</sup> 8/25/2005 managerial letter from HSBC Mark Smith to HBUS Aimee Sentmat, HBME Alan Kerr, and others, “GCL050047 – Compliance with OFAC sanctions,” HSBC OCC 3407565-569.

<sup>903</sup> See 8/25/2005 email from HBUS Alan Ketley to multiple HSBC colleagues, “GCL050047 – Compliance with OFAC Sanctions,” HSBC OCC 3407565-569.

<sup>904</sup> Id. at 568.

<sup>905</sup> 8/25/2005 email from Gary Boon to John Root, HSBC OCC 8876581. See also HSBC OCC 8876580.

<sup>906</sup> See 9/23/2005 email from HBEU Rod Moxley to HSBC John Allison and HSBC John Root, “OFAC sanctions,” HSBC OCC 8877213-214.

Group Compliance officials John Root and John Allison, noting that over just ten days, 821 of the transactions had involved Iran.<sup>907</sup>

In mid-September 2005, David Bagley provided an update to HSBC Group CEO Stephen Green on implementation of the July 2005 GCL. He explained that the “required specialist ‘U-turn’ team” had been established at HBME in Dubai, and a correspondent account with JP Morgan Chase had been opened to process compliant U-turn payments. He indicated that HBME was also using HBUS to process U-turns, as was HBEU. Mr. Bagley stated that “a number of Group Offices” had opened U.S. dollar accounts with HBME for routing Iranian payments, but added that he was not convinced that all HSBC affiliates had done so. As a result, he issued a reminder to the Regional Compliance Officers to discuss the matter with their business heads and requested confirmation by September 23, 2005.

Despite the issuance of the GCL and the existing arrangement with HBUS, an undisclosed Iranian-related transaction was discovered, leading an HBUS executive to believe the practice was ongoing. In November 2005, another bank stopped a transaction after HBUS had already processed it, without knowing the transaction had involved Iran. HBUS OFAC Compliance officer Elizabeth Protomastro notified Mr. Moxley at HBEU that, on November 7, 2005, a \$100,000 transaction involving Bank Mellī had been processed through HBEU’s account at HBUS without transparent documentation. She wrote:

“We are bringing this to your attention as this situation indicates that cover payment involving Iran are still being processed by PLC [referring to HBEU]. It was our understanding that Group payments involving Iran would be fully disclosed as to the originators and beneficiaries.”<sup>908</sup>

The payment had not been stopped by the HBUS OFAC filter because it did not contain any reference to Iran. She explained that four days later HBUS received a SWIFT message from HBEU stating that after contacting the remitter, the correct SWIFT should have been “MelliRTH94.” Since a U.S. bank cannot directly credit an Iranian bank, the payment was stopped and rejected by an unrelated bank. However, HBUS did not have the funds because Credit Suisse had already been paid through another correspondent bank owned by Credit Suisse. Ms. Protomastro explained that if the payment did involve Bank Mellī, it met the U-turn exception. However, she wanted to know why

<sup>907</sup> 9/23/2005 email from HBEU Rod Moxley to HSBC John Allison and others, “OFAC sanctions,” HSBC OCC 8877213-214.

<sup>908</sup> 11/23/2005 email from HBUS Elizabeth Protomastro to HBEU Rod Moxley and others, “Cover payment processed to Credit Suisse re ‘Bank Mellī’ – USD 100,000,” HSBC OCC 8876886-887.

HBEU continued to submit cover payments involving Iran which ran afoul of the new HBUS agreement.<sup>909</sup> Mr. Moxley responded that the transaction had uncovered a transparency issue with their payment system, which HBEU would work to address.<sup>910</sup>

A later review performed by an outside auditor at HBUS' request found that, even after the 2004 HBUS agreement, HSBC affiliates continued to send thousands of undisclosed Iranian U-turn transactions through their U.S. dollar accounts at HBUS and elsewhere. The auditor's review found that, from July 2002 to June 2005, HBEU and HBME together sent about 18,000 Iranian U-turn transactions through their U.S. dollar accounts of which about 90% did not disclose any connection to Iran.<sup>911</sup> The review found that, from July 2005 to June 2006, HBME sent about 3,000 Iranian U-turns through its U.S. dollar accounts of which about 95% were undisclosed. The comparable figures for HBEU were 1,700 U-turns of which 75% were undisclosed.<sup>912</sup>

#### **(h) Shifting Iranian Transactions from HBUS to JPMorgan Chase and Back Again**

In 2006, HBME sent a number of Iranian U-turn transactions through its new U.S. dollar account at JPMorgan Chase. When JPMorgan Chase decided to exit the business later in the year, HBME turned to HBUS to process them. Again, most of the U-turns HBME sent to HBUS were undisclosed.

**GCL 060011 Barring Cover Payments.** On April 6, 2006, less than a year after GCL 050047 was issued, HSBC Group issued another Group Circular Letter, entitled "U.S. Dollar Payments," essentially barring non-transparent cover payments for most OFAC sensitive transactions. It followed an enforcement action by the Federal Reserve Board on December 19, 2005, charging ABN AMRO Bank with OFAC violations for modifying payment instructions on wire transfers used to make OFAC sensitive transactions and using special procedures to circumvent compliance systems used to ensure the bank was in

<sup>909</sup> Id.

<sup>910</sup> Id. Mr. Moxley explained that when a customer directly inputs a transaction through an approved electronic channel, such as Hexagon, and the transaction achieves straight through processing, the cover MT202s are automatically generated by the HBEU payments system by the time the transactions hit the HBEU WOLF queue. He explained that the WOLF team was reviewing these payments to ensure the U-turn requirements were met, but acknowledged the lack of transparency for HBUS and indicated that a paper had already been submitted to the Head of Payment Services, Malcolm Eastwood, regarding the matter. Id.

<sup>911</sup> Deloitte Review of OFAC transactions, "March 29, 2012," HSBC OCC 8966113-150, at 143.

<sup>912</sup> Id. at 143. The figures for 2005 alone, were that HBEU and HBME together sent about 6,300 Iranian payments through U.S. dollar accounts in the United States, of which more than 90% were undisclosed. Id.

compliance with U.S. laws.<sup>913</sup> About two weeks after the enforcement action, an email exchange among HBEU, HBME, HBUS, and HSBC Group Compliance officials revealed:

“Group compliance is having a closer look at the [2005] GCL, with more specific reference to the recently published details of the ABN AMRO Enforcement Action. They are consider[ing] whether it is appropriate, for us to move to use of serial payment methodology. Group compliance needs to give opinion to Group CEO by next friday.”<sup>914</sup>

That same day, an HBUS Global Payments and Cash Management employee sent an email suggesting that commercial U.S. dollar payments be executed as “serial payments in which all payment party details are advised through HSBC Bank USA, your USD correspondent.” The HBUS employee also wrote: “This will allow our automated transaction monitoring system to appropriately analyze all group transactions for suspicious activity that would otherwise be hidden with the cover payment method. This system goes beyond simple OFAC checking to detect repetitive transaction trends indicative of money laundering or terrorist financing. This will assure regulators we are doing everything possible to comply with their requirements.”<sup>915</sup>

<sup>913</sup> See 12/19/2005 Federal Reserve Board, Financial Crimes Enforcement Network, Office of Foreign Assets Control, New York State Banking Department, and Illinois Department of Financial and Professional Regulation press release and Order of assessment of a civil money penalty, <http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/121905attachment2.pdf>. Five years later, in May 2010, the Justice Department imposed a \$500 million fine on ABN AMRO for removing information from wire transfers involving prohibited countries. See 5/10/2010 U.S. Department of Justice press release, <http://www.justice.gov/opa/pr/2010/May/10-crm-548.html> (“According to court documents, from approximately 1995 and continuing through December 2005, certain offices, branches, affiliates and subsidiaries of ABN AMRO removed or altered names and references to sanctioned countries from payment messages. ABN AMRO implemented procedures and a special manual queue to flag payments involving sanctioned countries so that ABN AMRO could amend any problematic text and it added instructions to payment manuals on how to process transactions with these countries in order to circumvent the laws of the United States. Despite the institution of improved controls by ABN and its subsidiaries and affiliates after 2005, a limited number of additional transactions involving sanctioned countries occurred from 2006 through 2007.”).

<sup>914</sup> 1/6/2006 email from HBEU Michele Cros to HBUS Bob Shetty and other HSBC, HBUS, HBEU, and HBME colleagues, “OFAC – Compliance with Sanctions GCL,” HSBC OCC 7688873.

<sup>915</sup> 1/6/2006 email from HBUS Richard Boyle to HBEU Michele Cros and HBUS Bob Shetty, “OFAC – Compliance with Sanctions GCL,” HSBC OCC 7688871-873. The email explained that ABN AMRO used their “USD nostro [account] with ABN AMRO New York to process USD payments originated through ‘special procedures’,” and that cover payments were used “as a method of masking Iranian and Libyan financial institutions as the originators of USD wire transfers.” It also discussed the recent regulatory actions as establishing “a precedent that the U.S. entity of a global group will be held responsible for the transactions in USD that may take place anywhere in the Group,” and mentioned other banks where regulatory action had been taken, including one that led to a cease and desist order prohibiting cover payments.

The new GCL 060011 required all HSBC Group affiliates to use fully transparent “serial” payments when sending U.S. dollar transactions through HBUS or any other U.S. correspondent, with full disclosure of all originators and beneficiaries.<sup>916</sup> Essentially, it required all HSBC affiliates to use the same procedure already established at HBUS. The GCL made an exception, however, for Iranian U-turns. Instead of requiring full disclosure in the transaction documents sent to a U.S. bank, the GCL allowed U-turns to “continue to be made as cover payments.” HSBC affiliates were required, however, to obtain the underlying payment details to ensure the transaction was permissible under OFAC regulations.<sup>917</sup> In addition, the GCL required all U-turn transactions to continue to be directed through HBME, which had established a dedicated team in Dubai for processing Iranian transactions. Because the GCL created an exception for Iranian U-turns, it did not stop the use of undisclosed transactions being sent by HBME and HBEU to HBUS.<sup>918</sup>

The policy’s effective date was April 30, 2006, and directed HBUS to require all third-party banks for which it provided U.S. dollar correspondent banking services to utilize the same fully transparent payment procedures by December 31, 2006.<sup>919</sup> The GCL also stated that dispensations from the deadlines could be obtained only from HSBC Group Compliance, with the concurrence of HBUS Compliance.

Soon after the GCL was announced, several HSBC affiliates requested and received dispensation from the April 2006 deadline, the most notable of which ended up giving HBEU more than a year to come into compliance with the new GCL.<sup>920</sup> HBEU obtained an initial

<sup>916</sup> See “GCL 060011 – US Dollar Payments (06/Apr/2006),” HSBC OCC 3407587.

<sup>917</sup> The GCL stated that “serial payments cannot qualify as U-turn payments,” but OFAC confirmed to the Subcommittee that U-turn payments could, in fact, be processed as serial payments. Subcommittee briefing by OFAC (5/8/2012).

<sup>918</sup> From April through June 2006, about 90% of the Iranian payments sent by HBME to U.S. dollar accounts at HBUS and elsewhere did not disclose their connection to Iran. In July 2006, an internal HSBC policy was issued that required HBME to send Iranian payments received from Group affiliates to HBUS on a serial basis. After July 2006, nearly 100% of the Iranian payments sent by HBME to the U.S. disclosed their connection to Iran. This internal policy did not apply to HBEU until late in 2007. From April 2006 through December 2007, about 50% of the 700 Iranian payments sent by HBEU to U.S. dollar accounts at HBUS and elsewhere did not disclose their connection to Iran. Deloitte Review of OFAC transactions, “March 29, 2012,” HSBC OCC 8966113-150, at 143.

<sup>919</sup> 4/6/2006 GCL 060011, “US Dollar Payments,” HSBC OCC 3407587.

<sup>920</sup> See 4/25/2006 – 5/5/2006 email exchanges among HSBC David Bagley, Group offices, and HBEU Rod Moxley, “Serial Payments – USD – GCL,” HSBC OCC 8877231-239. The emails indicate HSBC Asia Pacific requested dispensation for 19 specific countries until August 31, 2006, to allow time to change its payment systems. HBEU requested a dispensation until the end of October 2006 for MPS, citing a reconfiguration of the new GPP system that was expected by December 31, 2006. Michael Grainger in GTB – PCM, in conjunction with Operations and IT, requested a dispensation for HBEU sites through HUB until the end of 2006 to allow system changes to be implemented and piloted. David Bagley forwarded this email correspondence to John Allison with a request for consideration. He also noted that the serial methodology would

dispensation until October 31, 2006. On November 21, 2006, HBEU MPD head Malcolm Eastwood requested a second extension until after installation of a new GPS system scheduled for July 1, 2007. In July, due to “the huge volume of HBEU traffic and the potential resolution of the problem by an impending global system change,” HBEU received a third extension until November 2007.<sup>921</sup> Since HBEU was one of the top processors of payments for HSBC affiliates, its year and a half dispensation delayed full implementation of the new GCL until November 2007.<sup>922</sup>

The month after the new GCL was issued, HBUS Compliance official Anne Liddy sent an email to HSBC Group AML head Susan Wright indicating she had heard that David Bagley had “issued a dispensation” in relation to the new GCL. Ms. Liddy said that while she recalled discussions about how HSBC Group was “having a difficult time getting our Group offices to switch (mainly due to systems issues),” and the need to provide more time for clients to convert, she did not recall any dispensations being issued. She asked Ms. Wright for more information. Ms. Wright responded: “There have been a limited number of dispensations granted re HSBC’s own customers – John is the keeper of the dispensations and so will provide you with more detail.”<sup>923</sup> Based on Ms. Liddy’s email, it appears that Group Compliance may have granted dispensations, which then allowed cover payments to continue, without obtaining HBUS Compliance’s agreement, as the GCL required.

**JPMC Pulls Out.** In May 2006, about six months after HBME opened an account with JPMorgan Chase to process Iranian U-turns, JPMorgan Chase decided to stop processing them. On May 25, 2006, a JPMC representative informed HBME official Gary Boon that they would continue to process HBME’s dollar payment transactions, with the exception of Iranian transactions that reference details in the payment narrative.<sup>924</sup> On May 26, 2006, Mr. Bagley wrote to HSBC Group CEO Stephen Green that “JPMC have indicated that they are not willing to process these payments, I assume for reputational rather than regulatory reasons (given that they are within the U-turn exemption).”

put HBEU at a competitive disadvantage with regard to fees charged and the volume of customer complaints. *Id.*

<sup>921</sup> 7/4/2007 email from HBEU Rod Moxley to HBEU Tony Werby and Andy Newman, “[redacted] – HSBC arrangements for payment of the consideration,” HSBC OCC 8876901.

<sup>922</sup> A Deloitte review later determined that HBEU continued to send U-turns without any reference to Iran through the end of 2007, reflective of the dispensation granted to HBEU until November 2007. Deloitte Review of OFAC transactions, “March 29, 2012,” HSBC OCC 8966113, at 8966143. See also 11/21/2006 memorandum from HBEU Malcolm Eastwood to HSBC David Bagley and others, “GCL 060011 Dispensation,” HSBC OCC 8876896-899.

<sup>923</sup> See 7/16/2007 – 7/25/2007 email exchanges among HBUS Anne Liddy, HSBC Susan Wright, and HSBC John Allison, “Conversion of Clients to Serial Payment Method,” HSBC OCC 8875256.

<sup>924</sup> 5/25/2006 email from JPMC Ali Moosa to HBME Gary Boon and others, “US Dollar Transactional Activities via DDA at JPM,” HSBC OCC 3243782-787, at 786.

He continued that HBME would have to “pass these payments through HBUS.” He noted that they had previously received concurrence from HBUS to process the transactions, confirmed by HBUS CEO Martin Glynn.<sup>925</sup> That same day Mr. Bagley alerted HBUS AML head Teresa Pesce that “HBME have no choice but to now pass” U-turn exempt payments through HBUS.<sup>926</sup>

**Iranian Transactions Shift to HBUS.** HBUS was already processing Iranian U-turn transactions for HBEU, but HBME’s decision to route its Iranian U-turns through HBUS as well represented an increase in the volume of transactions that HBUS would have to identify and review.

On May 26, 2006, the same day he learned HBME would begin routing U-turns through its U.S. dollar account at HBUS, HBUS AML officer Alan Ketley emailed HBME’s Alan Kerr to clarify how HBUS would process the new volume of payments.<sup>927</sup> On May 30, 2006, Mr. Ketley wrote to HBME Gary Boon, copying HBUS AML head Teresa Pesce: “I’m unclear why you would be seeking to have HBUS handle this activity at no notice and am uncomfortable making arrangements for such sensitive activity in this fashion.” He requested examples of payment orders for routing through HBUS and asked for confirmation that HBME would not begin routing U-turns through HBUS until they had the “appropriate controls in place.” He was also concerned from a resource perspective, and stated that HBME intended to pass as many U-turns in a day as HBUS would normally handle in a busy month.<sup>928</sup> That same day, in response to his email to Mr. Boon, Ms. Pesce wrote: “Alan – we have no choice. JPMC won’t take them.”<sup>929</sup>

HBUS’ effort to ensure it had adequate staffing to review OFAC-related alerts from the HBME U-turns was made more difficult by varying information from HBME on the number of transactions to expect. On June 22, 2006, HBUS Compliance officials Anne Liddy and Alan Ketley reacted to an email exchange involving HBME’s Gary Boon discussing U-turn payment volumes being processed through HBUS as between 10 and 25 per day. Ms. Liddy wrote:

<sup>925</sup> 5/26/2006 email from HSBC David Bagley to HSBC Stephen Green, “US Dollar Transactional Activities via DDA at JPM,” HSBC OCC 3243782-787, at 784.

<sup>926</sup> 5/26/2006 email from HSBC David Bagley to HBUS Teresa Pesce and others, HSBC OCC 3243782-783.

<sup>927</sup> 5/26/2006 email from HBUS Alan Ketley to HBME Alan Kerr and HBME Gary Boon, “U-Turns,” OCC-PSI-00179654.

<sup>928</sup> 5/30/2006 email from HBUS Alan Ketley to HBME Gary Boon and HBME Alan Kerr, “U-Turns,” OCC-PSI-00179654.

<sup>929</sup> 5/30/2006 email from HBUS Teresa Pesce to HBUS Alan Ketley, “U-Turns,” HSBC OCC 3243965.



“[B]efore it was about 40. Yesterday 10. Now 25ish. BTW I am going to set up a m[ee]t[ing] with Terry and Denise (as our financier) to discuss resourcing for OFAC. It is out of hand.”<sup>930</sup>

In July 2006, HBME made a policy decision to go beyond the requirements of the Group-wide 2006 GCL and require all of its Iranian transactions to provide fully transparent payment information to its U.S. correspondents.<sup>931</sup>

In addition to the HBME transactions moving to HBUS, one other notable transaction involving Iran in 2006, pertained to 32,000 ounces of gold bullion valued at \$20 million. In May 2006, the HBUS London branch cleared the sale of the gold bullion between two foreign banks for the ultimate benefit of Bank Markazi, Iran’s Central Bank. HSBC indicated that it had been aware that Bank Markazi was the beneficiary, but had viewed the transaction as a permissible U-turn.<sup>932</sup> OFAC later told HBUS that it considered the transaction to be a “non-egregious” violation of law, and provided HBUS with an opportunity to explain why it should not be penalized for it; HBUS is still awaiting a final determination as to whether it will be penalized.<sup>933</sup>

#### (i) Getting Out

In October 2006, HSBC Group reversed course and decided to stop handling Iranian U-turns. In 2007, it went further and exited all business with Iran, subject to winding down its existing obligations.

**Increasing Risks.** In October 2006, Mr. Bagley provided a warning to his superiors that HSBC might want to reconsider processing U-turns. In an email on October 9, 2006, Mr. Bagley informed Stephen Green, who had become HSBC Group Chairman, Michael Geoghegan, who had become HSBC Group CEO, and David Hodgkinson, who used to head HBME but had become HSBC Group COO, that the risks associated with U-turns had increased due to “actions taken by the US government in withdrawing the U-Turn exemption from Bank Saderat.”<sup>934</sup> The prior month, in September 2006, HBUS had stopped an undisclosed transaction that involved Bank Saderat in Iran, which was added to the OFAC SDN list that same month.<sup>935</sup>

<sup>930</sup> 6/22/2006 email from HBUS Anne Liddy to HBUS Alan Ketley, “You Turn Payments,” HSBC OCC 3250730-732.

<sup>931</sup> Subcommittee briefing by Cahill Gordon & Reindel LLP (6/20/2012)

<sup>932</sup> 1/8/2010 Compliance Certificate from HSBC Christopher O’Donnell to HSBC David Bagley, OCC-PSI-00783419.

<sup>933</sup> See draft HSBC response to pre-penalty notice, OCC-PSI-00299323.

<sup>934</sup> 10/9/2006 email from HSBC David Bagley to HSBC Stephen Green, HSBC Michael Geoghegan, and HBME David Hodgkinson, “Iran – U-Turn Payments,” HSBC OCC 8874731-732.

<sup>935</sup> See 9/11/2006 email from HBUS Anne Liddy to HBUS Teresa Pesce, “HBME Wire payment USD 586.00 (Iran-Bank Saderat) – Reject & Report to OFAC,” HSBC OCC 4844209 and

Mr. Bagley wrote:

"During my recent visit to the US to attend a Wolfsberg meeting I was discretely advised of the following by a reliable source:

[U.S. Treasury] Under Secretary [Stuart] Levey ... and the more hawkish elements within the Bush administration were in favour of withdrawing the U-Turn exemption from all Iranian banks. This on the basis that, whilst having direct evidence against Bank Saderat particularly in relation to the alleged funding of Hezbollah, they suspected all major Iranian State owned banks of involvement in terrorist funding and WMD [weapons of mass destruction] procurement. ...

Certain US Government bodies have however made it known to a number of US banks that, as WMD related transactions are impossible to detect they would run an unacceptable reputational and regulatory risk were they to continue to process U-Turn transactions. The essence of the statement appears to be that as WMD related transactions would be heavily disguised (where even as a trade transaction documents would in effect be falsified) there is no safe way for a US bank to be involved in even a U-turn exempt transaction however stringent the scrutiny or monitoring. The clear implication made was that being found to be involved in a WMD related transaction, even if wholly innocently, would result in significant and severe action being taken against such a bank.

There were very strong indications that a number of US banks were therefore considering withdrawing from all U-turn related activity. If this happens those continuing in this market are likely to have an increased concentration.

Although I am satisfied that we have put appropriate controls in place to manage the U-Turn transactions, I am concerned that there are now increased risks in continuing to be involved in U-Turn USD payments which would justify our reconsidering our approach. I do recognize that the significance that tightening our policy to withdraw from U-Turn permitted transactions would have in terms of our Middle Eastern and Iranian business."<sup>936</sup>

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12/14/2006 email from Elizabeth Protomastro to John Allison and others, "OFAC – Wire payments blocked from HSBC offshore entities – USD 32,000 (re SDGT) and USD 2,538,939.33 (re Sudan)," HSBC OCC 3407608-609.

<sup>936</sup> 10/9/2006 email from HSBC David Bagley to HSBC Stephen Green, HSBC Michael Geoghegan, and HBME David Hodgkinson, "Iran – U-Turn Payments," HSBC OCC 8874731-732, at 732.

**GCL 060041 Ending U-turns.** Shortly after Mr. Bagley's email, HSBC decided to stop processing U-turns entirely. On October 25, 2006, HSBC Group Compliance issued Group Circular Letter 060041 which directed all Group offices to immediately stop processing U-turn payments.<sup>937</sup> An exception was made for permissible U-turn payments in connection with legally binding contractual commitments. HSBC decided to stop utilizing the U-turn exception two years before OFAC actually revoked the exception in November 2008.

Despite this decision, HSBC maintained a number of existing Iranian relationships.<sup>938</sup> On March 13, 2007, as a result of a "letter recently filed with the SEC "relating to the extent of our exposure to business in the so-called named countries (Sudan, Syria, and Iran),"<sup>939</sup> HSBC Group Compliance head David Bagley updated HSBC Group CEO Michael Geoghegan on HSBC's relationships with Iranian banks. He wrote:

"The existing levels of business, much of which is historic and subject to ongoing commitments, has been reviewed by CMP [Compliance] as against the requirements of Group policy, particularly where transactions are denominated in USD. Some of this activity related to pre-existing committed obligations which are binding on an ongoing basis. Group policy recognizes that we will have to allow such arrangements to run off. Relevant business colleagues are however aware of the Group's stance in terms of having no appetite for new or extended business activity involving Iranian counterparties. Where transactions appear to potentially conflict with Group policy those transactions are referred to GHQ CMP for determination and sign-off."<sup>940</sup>

The subject of Iran arose again a few months later, in June 2007, when Mr. Bagley informed HSBC Group CEO Michael Geoghegan that he had a private meeting with U.S. Treasury Under Secretary for Counter Terrorist Financing and Sanctions, Stuart Levey, during a recent Wolfsberg Group conference. Mr. Bagley indicated that Mr. Levey had questioned him about a HSBC client who, according to Mr. Levey, "had clearly been identified as having acted as a conduit for Iranian funding of" an entity whose name was redacted from the document by HSBC.<sup>941</sup> Mr. Bagley wrote: "Levey essentially threatened that if HSBC did not

<sup>937</sup> 10/25/2006 GCL 060041, "US OFAC Sanctions against Iran – U-Turn Exemption," HSBC OCC 3407606.

<sup>938</sup> See 2/6/2006 Project and Export Finance presentation, "Iranian portfolio," HSBC OCC 8876050-057. This presentation indicated that Project and Export Finance had not taken on any new Iranian business since 2005.

<sup>939</sup> 3/13/2007 email from HSBC David Bagley to HSBC Michael Geoghegan and others, "Iran," HSBC OCC 8878037-038.

<sup>940</sup> Id.

<sup>941</sup> See 6/8/2007 email exchanges among HSBC David Bagley, HSBC Michael Geoghegan and others, "Iran," HSBC OCC 8878214-216, at 215.

withdraw from relationships with [redacted] we may well make ourselves a target for action in the US.” Mr. Geoghegan responded: “This is not clear to me because some time ago I said to close this relationship other than for previously contractually committed export finance commitments.”<sup>942</sup> Mr. Bagley replied that the bank had only “limited relationships with [redacted] and in fact overall with Iranian banks.”

Mr. Bagley also wrote that he had discussed the matter with David Hodgkinson, and they agreed that HSBC “should immediately withdraw from [redacted] and also withdraw from all Iranian bank relationships in a coordinated manner.” He noted that the bank would have to honor “legally binding commitments” such as Project and Export Finance facilities.<sup>943</sup> These communications indicate that HSBC officials had previously known about problems with one particular Iranian client but that it did not end the relationship until after a warning from the U.S. Government.

**GCL 070049 on Exiting Iran.** On September 24, 2007, HSBC Group Compliance issued another Group Circular Letter, this one announcing the bank’s decision to exit Iran. GCL 070049 directed all account relationships with Iranian banks to be “closed as soon as possible” with sufficient notice as required by local law and to “allow an orderly run down of activity” and the “run-off of any outstanding exposures.” The GCL allowed ongoing payments involving existing facilities and transactions “where there are legally binding commitments,” such as Project and Export Finance facilities, to continue to be made as serial payments.<sup>944</sup> The deadline for closure of all Iranian accounts was November 30, 2007.

**2008 and 2009 Iranian Transactions.** After the GCLs terminating most business with Iran, internal bank documents show that hundreds of Iranian transactions per month continued to surface at HBUS during 2008 and 2009. These transactions were not, however, the type of undisclosed U-turn transactions that HSBC affiliates had been routinely sending through HBUS accounts prior to HSBC’s decision to exit Iran, but represented other types of transactions.

In 2008 and 2009, for example, HBUS’ London Banknotes office conducted a series of apparently prohibited transactions benefitting the Iranian Embassy in London. From July 22, 2008 to February 12, 2009, in more than 30 transactions, HBUS sold over €455,000 to HBEU which, in turn, sold them to the Embassy of Iran in the United

<sup>942</sup> Id. at 215.

<sup>943</sup> Id. at 214.

<sup>944</sup> 9/24/2007 GCL 070049, “Sanctions Against Iran,” OCC-PSI-00141530-531 and HSBC OCC 8876013-015.

Kingdom.<sup>945</sup> According to HBUS, “the funds were used to meet salary obligations” of the Iranian Embassy.<sup>946</sup> In addition, from December 5, 2008 to February 5, 2009, HBEU purchased over \$2,500 from the Embassy of Iran and resold the U.S. dollars to HBUS.<sup>947</sup> In 2009, after HBUS discovered that the London Banknotes office was engaging in currency transactions with the Iranian Embassy, it reported the transactions to OFAC and ended the activity.<sup>948</sup>

Other transactions involving Iran processed through HBUS’ correspondent accounts from 2008 to 2009, included a March 2009 wire transfer for \$300,000, which was mistakenly processed because a HBUS compliance officer did not realize a transaction reference to “Persia” implied a connection to Iran; and two wire transfers totaling over \$55,000 which involved a vessel owned by “NITC” which, until it was updated, HBUS’ OFAC filter did not recognize as the National Iranian Tanker Company.<sup>949</sup>

#### (j) Looking Back

According to an ongoing outside audit requested by HSBC, from 2001 to 2007, HBEU and HBME sent through their U.S. dollar accounts at HBUS and elsewhere nearly 25,000 OFAC sensitive transactions involving Iran totaling \$19.4 billion.<sup>950</sup> While some of those transactions were fully disclosed, most were not. According to the review conducted by Deloitte, from April 2002 to December 2007, more than 85% of those payments were undisclosed.<sup>951</sup>

Despite HBUS pleas for transparency and a 2004 internal agreement to use fully transparent procedures, HSBC affiliates HBEU and HBME often took action, including by deleting references to Iran or using cover payments, to prevent the Iranian transactions sent through their U.S. dollar correspondent accounts at HBUS from being caught in

<sup>945</sup> 3/20/2009 letter from HBUS Elizabeth Protomastro to OFAC, HSBC OCC 0630892. See also 1/25/2012 OCC Supervisory Letter HSBC-2012-03, “OFAC Compliance Program,” OCC-PSI-01768561, at Attachment (describing the transactions as involving over \$606,000 in U.S. dollars). [Sealed Exhibit.]

<sup>946</sup> Id.

<sup>947</sup> Id.

<sup>948</sup> See 3/24/2009 “Compliance Report for IQ09-HUSI Businesses,” sent by HBUS Lesley Midzain, to HNAH Janet Burak, HSBC David Bagley, and HBUS Paul Lawrence, HSBC OCC 3406981-3406996 at 982; 1/25/2012 OCC Supervisory Letter HSBC-2012-03, “OFAC Compliance Program,” OCC-PSI-01768561-566, at Attachment. [Sealed Exhibit.]

<sup>949</sup> See 1/25/2012 OCC Supervisory Letter HSBC-2012-03, “OFAC Compliance Program,” OCC-PSI-01768561-566, at Attachment. [Sealed Exhibit.]

<sup>950</sup> See Deloitte Review of OFAC transactions, “Results of the Transactions Review – UK Gateway, March 29, 2012,” HSBC-PSI-PROD-0197919, at 930.

<sup>951</sup> Subcommittee briefing by Cahill Gordon & Reindel LLP (6/20/2012); Deloitte presentation, “March 29, 2012,” at HSBC OCC 8966113. These payments were sent to the U.S. bank as cover payments, serial payments, or payments that were cancelled and then re-submitted by either an HSBC affiliate or the client without disclosing the connection to Iran in the payment message. Id. at 8966118 and 8966143.

the OFAC filter. Despite the fact that they viewed most of the transactions as permissible under U.S. law, concealing their Iranian origins helped avoid delays caused when HBUS' OFAC filter stopped the transactions for individualized review. HBME, in particular, requested that HBUS allow the use of cover payments to conceal Iranian transactions and circumvent the OFAC filter. When HBUS insisted on fully transparent transactions, the HSBC affiliates sent undisclosed transactions through their HBUS accounts anyway. HSBC Group leadership, including the heads of Compliance and AML, were aware in varying degrees of what the affiliates were doing, but for years, took no steps to insure HBUS was fully informed about the risks it was incurring or to stop the conduct that even some within the bank viewed as deceptive. The HSBC Group Compliance head took no decisive action even after noting that the practices "may constitute a breach" of U.S. sanctions. At HBUS, senior executives in the Compliance and payments areas knew about the actions being taken by HSBC affiliates to send concealed Iranian transactions through their U.S. dollar correspondent accounts, but were unable or unwilling to obtain information on the full scope of the problem, bring the issue to a head, and demand its resolution at the highest levels of the bank to ensure all U-turns were reviewed for compliance with the law.

## **(2) Transactions Involving Other Countries**

Iranian transactions were not the only potentially prohibited transactions sent through HBUS. Transactions involving Burma, Cuba, North Korea, and Sudan, as well as persons named on the SDN list, were also sent through HBUS accounts, although to a much lesser extent than those related to Iran. HSBC affiliates were one major source of the transactions, due to poor compliance with HSBC Group policy barring U.S. dollar transactions with prohibited countries or persons, and requiring transparent transactions, but the majority of these transactions appear to have been sent through HBUS by unrelated financial institutions. The transactions sent by HSBC affiliates also do not appear to be the product of the same kind of systematic effort to avoid the OFAC filter as was the case with the Iranian U-turns. Some of the transactions sent through HBUS had references to a prohibited person or country deleted or used cover payments, and passed undetected through the OFAC filter. Others openly referenced a prohibited country or person, but escaped detection by HBUS' OFAC filter or HSBC's WOLF filter due to poor programming. Still others were caught by a filter, but then released by HBUS personnel, apparently through human error. An ongoing review by an outside auditor, examining HBUS transactions over a seven-year period from 2001 to 2007, has so far identified about

2,500 potentially prohibited transactions involving countries other than Iran, involving assets totaling about \$322 million.<sup>952</sup>

**(a) 2005 and 2006 GCLs**

The documents examined by the Subcommittee show that HBUS' OFAC filter blocked a transaction involving a prohibited country other than Iran as early as 2002.<sup>953</sup> Internal bank documents indicate, however, that transactions involving prohibited persons or countries other than Iran did not receive the same level of attention as the Iranian transactions, until issuance of the July 28, 2005 Group Circular Letter 050047 which barred HSBC affiliates from executing U.S. dollar transactions involving any person or country prohibited by OFAC.<sup>954</sup>

Shortly after the GCL was issued, the HSBC Group head of Global Institutional Banking, Mark Smith, issued a managerial letter, in August 2005, providing guidance on implementing the new policy.<sup>955</sup> His letter summarized the Group's relationships with Burma, Cuba, Iran, North Korea, Sudan, and Zimbabwe. He explained that most of HSBC Group's business with Sudan and Cuba was conducted in U.S. dollars and "discussions already initiated with the affected banks will dictate the extent of our ongoing relationship." The guidance also clarified that the revised policy applied only to U.S. dollar transactions.<sup>956</sup>

In addition, the managerial letter identified correspondent relationships affected by the new policy.<sup>957</sup> It provided the number of open correspondent accounts with financial institutions in Cuba, Burma, Iran, North Korea, and Sudan. It also explained:

"The revised policy does not represent an automatic exit strategy with regards to affected clients. Non-USD business (and for Iran, U-turn exempt transactions) may continue to be undertaken. However, for a number of reasons eg. operational simplicity, where the remaining non-USD business is uneconomic or where

<sup>952</sup> Deloitte presentation, "Results of the Transactions Review – UK Gateway, March 29, 2012," HSBC-PSI-PROD-0197919-989, at 930. Since the Deloitte review has yet to examine an additional set of U.S. dollar transactions and does not include any transactions during the period 2008 to 2010, its figures represent a conservative analysis of the potentially prohibited transactions transmitted through HBUS.

<sup>953</sup> On May 21, 2002, a \$3 million payment from HBEU was blocked by HBUS' OFAC filter due to a reference in the payment details to Cuba. See 4/24/2006 email from HBUS Charles Delbusto to HBUS Michael Gallagher, "ING Writeup," HSBC OCC 1933599-601. See also 11/14/2002 memorandum from HBEU Malcolm Eastwood to HBUS Denise Reilly and HBEU Geoff Armstrong, "Compliance – OFAC Issues in General and Specific to Iran," HSBC OCC 7688824.

<sup>954</sup> 7/28/2005 GCL 050047, "Compliance with Sanctions," HSBC OCC 3407560-561.

<sup>955</sup> 8/25/2005 managerial letter from HSBC Mark Smith to HBUS Aimee Sentmat, HBME Alan Kerr, and others, "GCL050047 – Compliance with OFAC sanctions," HSBC OCC 3407565-569.

<sup>956</sup> Id at 566.

<sup>957</sup> Id.

the client concludes they will have to conduct their business with an alternative provider, the ultimate outcome may be the closure of certain relationships. Verbal discussions with affected clients would be preferable. Any written correspondent seeking to clarify the Group's revised policy should be cleared with local Compliance."<sup>958</sup>

The letter noted that "any dispensation from the terms of the GCL require[d] Group Compliance concurrence."<sup>959</sup>

In September 2005, senior HBEU payments official Rod Moxley completed an analysis of U.K. transactions over a 10-day period that were stopped by HSBC's WOLF filter and involved Burma, Cuba, or Sudan.<sup>960</sup> He forwarded the results to senior HSBC Group Compliance officials John Root and John Allison, noting that there were "a considerable number of USD denominated transactions" for Sudan, and "also to a lesser extent" Cuba and Burma. He also noted that prior to the effective date of the new GCL, these payments would have been stopped by the WOLF filter but then allowed to proceed, "providing they did not infringe on UN/EU sanctions or terrorist parameters," since HBEU was "not affected directly by OFAC sanctions," but the new GCL would require these payments to be blocked due to OFAC prohibitions.

Mr. Moxley also wrote:

"Since the issuance of the GCL, it has been made clear that US interests are of paramount importance and we should do nothing, when processing payment transactions, which would leave HBUS in a vulnerable position. The issues surrounding Iran have overshadowed other OFAC payments recently, however, I can advise that we have not so far physically returned any USD payments involving Sudan, Cuba or Burma. I feel we now need to look far more closely at these payments to ensure compliance with the GCL."<sup>961</sup>

Mr. Moxley asked about two alternative responses to transactions stopped by the WOLF filter and barred by the new GCL. One was to continue processing the transactions but ensure that the payment was routed in such a way "that they are not frozen in the US." He explained: "This will involve intelligent usage of the routing system but may perpetuate similar scenarios to those encountered with Iran (customer instructions saying Do not mention Sudan or routing which does not

<sup>958</sup> Id. at 568.

<sup>959</sup> Id.

<sup>960</sup> See 9/23/2005 email from HBEU Rod Moxley to HSBC John Allison and HSBC John Root, "OFAC sanctions," HSBC OCC 8877213-214.

<sup>961</sup> Id.



make it apparent that these are Sudanese payments).” This alternative seems to suggest that HSBC would engage in Iran-style transactions in which transaction details are stripped out to avoid triggering the OFAC or WOLF filters. His second alternative was to “strictly” apply the GCL “and return the payments unprocessed.” He wrote that his “instinct” was to “return all such USD payments ... so that our US colleagues’ position is not compromised,” but wanted confirmation from HSBC Group Compliance before taking that action.<sup>962</sup> The documents reviewed by the Subcommittee do not indicate what response he received. When asked about his email, Mr. Moxley told the Subcommittee that he could not recall how his inquiry was resolved.<sup>963</sup>

About a year later, on April 6, 2006, HSBC Group issued another Group Circular Letter, GCL 060011, which required all HSBC affiliates, when sending U.S. dollar transactions through a correspondent account at HBUS or another U.S. financial institution to use so-called “serial payments” specifying the transaction’s chain of originators and beneficiaries.<sup>964</sup> This policy change was intended to stop HSBC affiliates from using cover payments, which provide less information for banks when processing payments and which can mask potentially prohibited transactions sent through HBUS or other U.S. banks. Its effective date for HSBC affiliates was April 30, 2006; HBUS was required to impose the policy on all third-party banks for which it provided U.S. dollar correspondent banking services by December 31, 2006.<sup>965</sup> At the same time, HSBC Group Compliance granted a year-long extension to HBEU, giving it until November 2007, before it was required to use serial payment instructions.<sup>966</sup>

Internal bank documents indicate that OFAC sensitive transactions involving countries other than Iran took place both before and after the 2005 and 2006 GCLs.

#### **(b) Transactions Involving Cuba**

Internal bank documents indicate that, from at least 2002 through 2007, HBUS processed potentially prohibited U.S. dollar transactions involving Cuba. HSBC affiliates in Latin America, in particular, had many Cuban clients and sought to execute transactions on their behalf in

<sup>962</sup> Id. at 214.

<sup>963</sup> Subcommittee Interview of Rod Moxley (6/7/2012).

<sup>964</sup> 4/6/2006 GCL 060011, “US Dollar Payments,” HSBC OCC 3407587.

<sup>965</sup> Id.

<sup>966</sup> See 4/25/2006 - 5/5/2006 email exchanges among HSBC David Bagley, Group offices, and HBEU Rod Moxley, “Serial Payments – USD – GCL,” HSBC OCC 8877231-239. Subcommittee briefing by OFAC (5/8/2012).

U.S. dollars, despite the longstanding, comprehensive U.S. sanctions program and the OFAC filter blocking such transactions.<sup>967</sup>

In August 2005, a month after HSBC Group issued its new GCL policy barring HSBC affiliates from engaging in U.S. dollar transactions in violation of OFAC prohibitions, HBUS circulated an email identifying correspondent relationships that would be affected.<sup>968</sup> The email stated: "An overriding observation is that the revised policy will most significantly impact the Cuban and Sudan correspondent bank relationships." It also observed: "For Sudan and Cuba, most of our business is conducted in USD and the discussions already initiated with the affected banks will dictate the extent of our ongoing relationships."<sup>969</sup>

In September 2005, HSBC Group Compliance head David Bagley told HSBC Group CEO Stephen Green that they had closed "a number of USD correspondent relationships with Cuban ... banks."<sup>970</sup> On October 3, 2005, Mr. Bagley sent an email to Matthew King, then head of HSBC Group Audit, that Mr. Green was "particularly concerned" about ensuring the 2005 GCL was "properly and fully implemented across the Group."<sup>971</sup> Mr. Bagley asked Mr. King to use HSBC's internal audits to help gauge compliance with the new GCL. Mr. King relayed the request to various HSBC auditors and, in response, learned from HSBC Mexico (HBMX) Compliance that the OFAC list had not been fully integrated into HBMX's monitoring system and would not be for another six months, until April 2006.<sup>972</sup> HBMX reported that, pending the systems integration, it had set up "manual controls" in several divisions to implement the new GCL, but "no automated means exists to ensure that these controls are properly being carried out."<sup>973</sup> HBMX explained further that its "greatest exposure" was "the volume of business historically carried out by HBMX customers with Cuba in US dollars."<sup>974</sup>

Mr. King responded that the HBMX transactions raised two sets of concerns, one with respect to the U.S. dollar transactions involving Cuba being run through HBMX's correspondent account at HBUS, and the

<sup>967</sup> See OFAC "Sanctions Programs and Country Information," Cuba sanctions (last updated 5/11/2012), <http://www.treasury.gov/resource-center/sanctions/Programs/pages/cuba.aspx>.

<sup>968</sup> See 8/25/2005 email from HBUS Alan Ketley to multiple HSBC colleagues, "GCL050047 – Compliance with OFAC Sanctions," HSBC OCC 3407565-569.

<sup>969</sup> *Id.* at 3407568.

<sup>970</sup> 9/19/2005 email from HSBC David Bagley to HSBC Stephen Green and HSBC Richard Bennett, "GCL050047 "Compliance With Sanctions," HSBC OCC 8874360-362.

<sup>971</sup> 10/3/2005 email from HSBC David Bagley to HSBC Matthew King, "GCL 050047 – Compliance with Sanctions," HSBC OCC 8874359-360.

<sup>972</sup> 10/14/2005 email from HBMX Graham Thomson to HSBC Matthew King, "GCL 050047 – Compliance with Sanctions," HSBC OCC 8874358-359.

<sup>973</sup> *Id.*

<sup>974</sup> *Id.*

second with respect to non-U.S. dollar transactions being “transmitted through the HBUS TP gateway,” referring to a U.S.-based server that handled transfers from Mexico and South America.<sup>975</sup> Since the United States prohibited transactions involving Cuba, both types of transactions raised questions about whether they ran afoul of the OFAC list and the 2005 GCL. Mr. King responded:

“I note HBMX continues to process USD payments involving Cuba. It is very important that is stopped immediately as the regulators are getting very tough and the cost to the Group could be considerable if a breach occurs, both in terms of the fine and the rectification work which is likely to be a pre-requisite to any settlement.

With regard to non-USD payments as described above, GHQ CMP [Group Headquarters Compliance] are urging HBUS to screen out these transactions to avoid any risk, and HBMX would have to put measures in place to p[re]-empt customer dismay.”<sup>976</sup>

HSBC affiliates from outside of Latin America also occasionally sent potentially prohibited transactions involving Cuba through their HBUS accounts. For example, in December 2006, a payment for \$15,350 that had been sent by an HSBC affiliate in the Asia-Pacific region was blocked by HBUS, because the transaction documents referred to “Air Tickets Moscow Havana Moscow 3Pax.”<sup>977</sup>

In 2007, an internal HSBC document entitled, “Information Requested in Connection With: (North Korea, Cuba, and Myanmar),” revealed that, as of May 2007, HSBC affiliates in Mexico and Latin America were still providing U.S. dollar accounts to Cuban clients, in apparent violation of HSBC Group GCL policy and OFAC regulations.<sup>978</sup> The document indicated that HBMX had 23 Cuban customers with U.S. dollar accounts containing assets in excess of \$348,000, and 61 Cuban customers holding both U.S. dollar and Mexican peso accounts with assets totaling more than \$966,000.<sup>979</sup> In addition, the report disclosed that HSBC affiliates in Colombia, Costa Rica, El Salvador, Honduras, and Panama were also providing U.S. dollar accounts to Cuban nationals or the Cuban Embassy. The document also indicated that arrangements had been made to “cancel all

<sup>975</sup> 10/17/2005 email from HSBC Matthew King to HBMX Graham Thomson, HSBC David Bagley, and others, “GCL 050047 “Compliance With Sanctions,” HSBC OCC 8874357-358.  
<sup>976</sup> Id.

<sup>977</sup> 12/17/2006 email from HBAP Donna Chan to HBUS Alan Ketley and others, “TT NSC770937 Dated 13Dec06 For USD15,350.21,” HSBC OCC 3287261-262.

<sup>978</sup> 5/18/2007 HSBC document, “Information Requested in Connection With: (North Korea, Cuba, and Myanmar),” HSBC OCC 8876088-095, at 8876093-095.

<sup>979</sup> Id. In addition, 1, 284 Cuban clients had nearly 2250 HBMX accounts holding solely Mexican pesos, with assets exceeding a total of \$8.9 million. Id. at 8876093.

business relationships with” Cuban clients, in relation to U.S. dollar accounts or commercial relationships for the entire region.<sup>980</sup> These steps were being taken almost two years after the July 2005 GCL had prohibited HSBC affiliates from executing U.S. dollar transactions involving OFAC sensitive persons.

### (c) Transactions Involving Sudan

A second set of OFAC sensitive transactions involved Sudan, a country which is also subject to a comprehensive sanction program in the United States.<sup>981</sup> Internal bank documents indicate that, from at least 2005 to 2008, HBUS processed a considerable volume of U.S. dollar transactions involving Sudan that, once the new GCL took effect, should have decreased. The reasons they continued include a wide range of factors, from inadequate bank staffing reviewing OFAC transactions, to deceptive wire transfer documentation, to ongoing actions by HSBC affiliates to send these potentially prohibited transactions through HBUS.

In August 2005, a month after HSBC Group issued the GCL policy barring HSBC affiliates from engaging in U.S. dollar transactions in violation of OFAC prohibitions, HSBC Group head of Global Institutional Banking, Mark Smith, circulated a managerial letter identifying correspondent relationships that would be affected.<sup>982</sup> The letter stated: “An overriding observation is that the revised policy will most significantly impact the Cuban and Sudan correspondent bank relationships.” It also observed: “For Sudan and Cuba, most of our business is conducted in USD and the discussions already initiated with the affected banks will dictate the extent of our ongoing relationships.”<sup>983</sup> In September 2005, a senior HBEU payments official Rod Moxley completed an analysis of U.K. transactions over a 10-day period that were stopped by the WOLF filter and noted “a considerable number of USD denominated transactions” for Sudan.<sup>984</sup>

A year after the GCL took effect, however, one affiliate attempted to clear a Sudan-related transaction through HBUS in violation of company policy. On December 6, 2006, HBUS blocked a \$2.5 million payment originating from an HSBC branch in Johannesburg because the

<sup>980</sup> 5/18/2007 HSBC report, “Information Requested in Connection With: (North Korea, Cuba, and Myanmar),” HSBC OCC 8876088-095 at 8876093-095.

<sup>981</sup> See OFAC “Sanctions Programs and Country Information,” Sudan sanctions (last updated 2/1/2012), <http://www.treasury.gov/resource-center/sanctions/Programs/pages/sudan.aspx>.

<sup>982</sup> 8/25/2005 managerial letter from HSBC Mark Smith to HBUS Aimee Sentmat, HBME Alan Kerr, and others, “GCL050047 – Compliance with OFAC sanctions,” HSBC OCC 3407565-569; 8/25/2005 email from HBUS Alan Ketley to multiple HSBC colleagues, “GCL050047 – Compliance with OFAC Sanctions,” HSBC OCC 3407565-569.

<sup>983</sup> Id. at 568.

<sup>984</sup> See 9/23/2005 email from HBEU Rod Moxley to HSBC John Allison and HSBC John Root, “OFAC sanctions,” HSBC OCC 8877213-214.

payment details referenced the “Sudanese Petroleum Corporation.”<sup>985</sup> Although the payment had also been stopped by the WOLF filter in HSBC Johannesburg, an employee there had approved its release and sent the transaction through their correspondent account at HBUS. An internal email from HSBC Johannesburg explained that the release of the funds was:

“a genuine error in an attempt to push the day[']s work through before the cut-off time. I believe the loss of three staff in the department leaving only two permanent staff remaining is causing the[m] to work towards clearing their queues rather than slow down to read the warnings such as these. ... Having said that I also feel it is a matter of training where seeing the word ‘Sudan’ alone should have been warning enough.”<sup>986</sup>

The email also noted that the transaction had been sent by Commercial Bank of Ethiopia, which was “aware that this payment may not go through as they have attempted to make this payment via their other correspondent banks and failed.”<sup>987</sup>

In July 2007, HBUS discovered that another client, Arab Investment Company, had been sending “multiple Sudan-related payments” through its U.S. dollar account at HBUS, that other banks later blocked for specifying a Sudanese originator or beneficiary, “suggesting that HBUS has been processing cover payments for this client.”<sup>988</sup> An email identified seven wire transfers over a one-year period, collectively involving more than \$1.1 million, in which the documentation provided to HBUS made no reference to Sudan, preventing the transfers from being stopped by HBUS’ OFAC filter.<sup>989</sup> The email noted that two of the wire transfers later blocked by other banks had resulted in letters from OFAC seeking an explanation for HBUS’ allowing the transfers to take place, and suggested closing the client account to prevent more such incidents.<sup>990</sup> On another occasion, HBUS identified five wire transfer payments between January and November 2007, totaling more than \$94,000, that turned out to be intended for a Sudanese company, but had been processed as straight

<sup>985</sup> See 12/14/2006 email from HBUS Elizabeth Protomastro to HBUS John Allison and others, “OFAC – Wire payments blocked from HSBC offshore entities – USD 32,000 (re SDGT) and USD 2,538,939.33 (re Sudan),” HSBC OCC 3407608-609.

<sup>986</sup> 12/15/2006 email from HSBC Gimhani Talwate to HSBC Krishna Patel, “PCM Operational error. Funds frozen in USA – payment on behalf of Commercial Bank of Ethiopia,” OCC-PSI-00610597, at 8.

<sup>987</sup> Id.

<sup>988</sup> 7/8/2007 email from HBEU Joe Brownlee to HBEU Giovanni Fenocchi, forwarded by HBEU Peter May to HBUS Anne Liddy and HBUS Alan Ketley, “Arab Investment Company Reportable Event #3948 Notification Entity,” OCC-PSI-00620281, at 2.

<sup>989</sup> Id.

<sup>990</sup> Id.

through payments at HBUS, because “there was no beneficiary address and no mention of ‘Sudan’.”<sup>991</sup>

In still other cases, wire transfers clearly referencing Sudan were stopped by HBUS’ OFAC filter for further review, but then allowed by HBUS staff to proceed. An HBUS internal report on OFAC compliance noted, for example, two blocked wire transfers involving Sudan, one for over \$44,000 and the other for over \$29,000, blocked on November 5 and December 7, 2007, respectively, by HBUS’ OFAC filter, but subsequently “released due to human error.”<sup>992</sup>

In August 2008, HBUS noted that it was then holding over \$3.2 million in Sudan-related payments sent to the bank from other HSBC affiliates.<sup>993</sup> The bulk of the funds came from blocking a \$2.5 million payment from HSBC Johannesburg destined for the Sudanese Petroleum Corporation, but three other Sudan-related payments from HSBC affiliates were also identified, a \$300,000 payment sent by HSBC Hong Kong; a payment for more than \$367,000 payment from HSBC Dubai, and a payment for more than \$58,000 from British Arab Commercial Bank Ltd. The email listing these blocked funds noted that a court order was seeking transfer of the funds to a Federal court in the United States in connection with a lawsuit seeking compensation for the families of 17 U.S. sailors killed in a 2000 terrorist attack on the USS Cole in Yemen.<sup>994</sup>

In August 2010, in connection with an effort to exit correspondent relationships with 121 international banks that HBUS determined it could no longer support, HBUS CEO Irene Dorner sent an email noting references to 16 banks in Sudan. Ms. Dorner wrote:

“In Phase 2 there will be Trade names the exit for which may be more complicated but to give you a flavo[u]r of the problem we seem to have 16 correspondent banks in Sudan which cannot be right.”<sup>995</sup>

#### **(d) Transactions Involving Burma**

Another set of OFAC sensitive transactions involved Burma, also referred to as Myanmar, a country which, like Cuba and Sudan, was

<sup>991</sup> “OFAC Compliance Team Monthly Update Date - January 2008,” OCC-PSI-00631007.

<sup>992</sup> 4/2/2008 HBUS memorandum, “Management Report for 1Q2008 for OFAC Compliance,” OCC-PSI-00633713.

<sup>993</sup> 8/8/2008 email from HBUS Anne Liddy to HSBC Susan Wright and others, “USS Cole Case,” OCC-PSI-00304783, at 2-3.

<sup>994</sup> Id.

<sup>995</sup> 8/20/2010 email from HBUS Irene Dorner to HSBC Andrew Long and others, “Project Topaz US Urgent Requirements,” HSBC OCC 8876105-106.

subject to a comprehensive sanctions program in the United States.<sup>996</sup> This program, first imposed in 1997, remains in effect today, although certain aspects of the program were suspended in May 2012.<sup>997</sup> Internal bank documents indicate HBUS processed potentially prohibited transactions involving Burma from at least 2005 to 2010.

One of the earliest references to transactions with Burma in the documents reviewed by the Subcommittee is a January 2005 email involving HBUS' Global Banknotes business, which involves the buying and selling of large quantities of physical U.S. dollars to non-U.S. banks.<sup>998</sup> The email, written by HSBC Group Compliance head David Bagley, described a transaction in which HBUS purchased \$2.9 million in U.S. dollars from a client, determined that the dollars had come from a certain party whose name was redacted by HBUS, and noted: "Myanmar is currently subject to OFAC regulations prohibiting any transactions by US persons relating to Myanmar counterparties." Mr. Bagley wrote:

"There appears little doubt that the transaction is a breach of the relevant OFAC sanction on the part of HBUS, that it will need to be reported to OFAC and as a consequence there is a significant risk of financial penalty. It does not appear that there is a systemic issue, rather we are dealing with an individual incident, although given the potential seriousness of the breach external lawyers have been instructed to assist with the process of resolving matters with OFAC."<sup>999</sup>

In July 2005, HSBC Group issued its new GCL policy barring all HSBC affiliates from engaging in U.S. dollar transactions in violation of OFAC prohibitions. A few days later, on August 25, 2005, HSBC Group head of Global Institutional Banking, Mark Smith, circulated a managerial letter, referenced previously, identifying correspondent relationships that would be affected.<sup>1000</sup> The letter noted that the "Group has 2 account relationships with Myanmar entities," and stated that the

<sup>996</sup> See OFAC "Sanctions Programs and Country Information," Burma sanctions (last updated 4/17/2012), <http://www.treasury.gov/resource-center/sanctions/Programs/pages/burma.aspx>.

<sup>997</sup> *Id.* The U.S. Government suspended certain aspects of the Burma sanctions on May 17, 2012. See "U.S. Eases Myanmar Financial Sanctions," *Wall Street Journal*, Jay Solomon (5/17/2012), <http://online.wsj.com/article/SB10001424052702303879604577410634291016706.html> ("[T]he U.S. Treasury Department is maintaining and updating its list of sanctioned Myanmar military companies, business tycoons and generals who allegedly engaged in human-rights violations and corruption.").

<sup>998</sup> See 1/21/2005 email from HSBC David Bagley to HSBC Stephen Green and Richard Bennett, "Compliance Exception," HSBC OCC 8873671.

<sup>999</sup> *Id.*

<sup>1000</sup> 8/25/2005 managerial letter from HSBC Mark Smith to HBUS Aimee Sentmat, HBME Alan Kerr, and others, "GCL050047 - Compliance with OFAC sanctions," HSBC OCC 3407565-569; 8/25/2005 email from HBUS Alan Ketley to multiple HSBC colleagues, "GCL050047 - Compliance with OFAC Sanctions," HSBC OCC 3407565-569.

“GCL applies in full,” implying both relationships would have to be terminated. In September 2005, a senior HBEU payments official, Rod Moxley, who analyzed U.K. transactions stopped by the WOLF filter over a 10-day period noted that a number of the U.S. dollar transactions involved Burma.<sup>1001</sup>

After the GCL’s 2005 effective date, Burma-related transactions appear to have been reduced, but continued to occur. One example is a \$15,000 payment that originated in Burma on January 18, 2008, was processed as a straight-through payment at HBUS, and blocked by the OFAC filter at another bank involved with the transaction.<sup>1002</sup> An HBUS email explained that the payment had not been blocked at HBUS, because its OFAC filter didn’t recognize “Yangon,” the former capital of Burma, also called “Rangoon,” as a Burma-related term. According to the email, it was the second payment involving “Yangon” that was missed by the HBUS filter. HBUS Compliance head Carolyn Wind requested that the filter be fixed immediately: “We are running too much risk that these misses will cause OFAC to start questioning the effectiveness of our controls.”<sup>1003</sup>

Four months later, HBUS blocked an April 2008 wire transfer for \$12,060 headed for the account of an SDN-listed entity at Myanmar Foreign Trade Bank. An internal bank document noted that the payment had been blocked by HBUS due to “references to Yangon and Myanmar, rather than blocking it due to the sanctioned entity[']s involvement.” The document noted that the bank code “for the sanctioned entity was not included in the payments filter, as per agreed upon procedure with the UK WOLF team,” and a systems fix was implemented in October 2008.<sup>1004</sup>

In May 2010, two additional Burma-related U.S. dollar transactions were processed by HBUS, due to limitations in the WOLF filter. In one instance, a payment was not blocked, because “the filter did not list ‘Burmese’ as an a.k.a. [also known as] for Burma.” In the other instance, the “filter did not identify ‘Mynmar’ as a possible reference to Myanmar.”<sup>1005</sup>

<sup>1001</sup> See 9/23/2005 email from HBEU Rod Moxley to HSBC John Allison and HSBC John Root, “OFAC sanctions,” HSBC OCC 8877213-214.

<sup>1002</sup> See 1/25/2008 email exchanges among HBUS Carolyn Wind, HBUS Mike Ebbs, and others, “Myanmar-related payment – Missed by filter (‘Yangon’),” HSBC OCC 0616168-178, at 169.

<sup>1003</sup> Id. at 168.

<sup>1004</sup> Undated Global Transaction Banking report, “All Open Reportable Events,” OCC-PSI-00823408, at 4.

<sup>1005</sup> 1/1/2010 – 5/31/2010 Compliance Certificate from HSBC David Bagley to HNAH Brendan McDonagh and HNAH Niall Booker, OCC-PSI-01754176, at 4.



**(e) Transactions Involving North Korea**

Still another set of OFAC sensitive transactions involved North Korea which, unlike Burma, Cuba and Sudan, is not subject to a comprehensive U.S. sanctions program, but has particular persons and entities included in the OFAC SDN list.<sup>1006</sup>

In August 2005, a month after HSBC Group issued the GCL policy barring HSBC affiliates from engaging in U.S. dollar transactions in violation of OFAC prohibitions, HSBC Group head of Global Institutional Banking, Mark Smith, circulated a managerial letter identifying correspondent relationship that would be affected.<sup>1007</sup> The letter stated: "The Group has 3 account relationships with North Korean entities. These are all inhibited. We have been seeking to close the accounts, and will continue to do so, for some time but have not been able to elicit a response from the banks concerned."<sup>1008</sup>

Nearly two years later, in 2007, an internal HSBC document entitled, "Information Requested in Connection With: (North Korea, Cuba, and Myanmar)," revealed that, as of May 2007, HSBC affiliates in Mexico and Latin America were providing U.S. dollar accounts to North Korean clients.<sup>1009</sup> The document indicated that HSBC Mexico (HBMX) had nine North Korean customers with nine U.S. dollar accounts holding assets exceeding \$46,000, and seven North Korean customers with both U.S. dollar and Mexican peso accounts whose assets totaled more than \$2.3 million.<sup>1010</sup> The document indicated that arrangements had been made to "cancel all business relationships with" North Korea, in relation to U.S. dollar accounts or commercial relationships for the entire region.

In addition, HBUS did not close a U.S. dollar account with the Foreign Trade Bank of the Democratic People's Republic of Korea until

<sup>1006</sup> See OFAC "Sanctions Programs and Country Information," North Korea sanctions (last updated 6/20/2011), <http://www.treasury.gov/resource-center/sanctions/Programs/pages/nkorea.aspx>.

<sup>1007</sup> 8/25/2005 managerial letter from HSBC Mark Smith to HBUS Aimee Sentmat, HBME Alan Kerr, and others, "GCL050047 – Compliance with OFAC sanctions," HSBC OCC 3407565-569; 8/25/2005 email from HBUS Alan Ketley to multiple HSBC colleagues, "GCL050047 – Compliance with OFAC Sanctions," HSBC OCC 3407565-569.

<sup>1008</sup> 8/25/2005 managerial letter from HSBC Mark Smith to HBUS Aimee Sentmat, HBME Alan Kerr, and others, "GCL050047 – Compliance with OFAC sanctions," HSBC OCC 3407565-569, at 567.

<sup>1009</sup> 5/18/2007 HSBC document, "Information Requested in Connection With: (North Korea, Cuba, and Myanmar)," HSBC OCC 8876088-095, at 093-095.

<sup>1010</sup> Id. In addition, 92 North Korean clients had 137 HBMX accounts holding solely Mexican pesos, with assets exceeding a total of \$697,000. Id. at 093.

April 28, 2010, although a review of the account indicated that no U.S. dollar activity had taken place in it since 2007.<sup>1011</sup>

#### (f) Other Prohibited Transactions

In addition to transactions involving jurisdictions subject to U.S. sanctions programs, some transactions sent to HBUS involved prohibited individuals or entities named on the OFAC SDN list. While many of these transactions were not sent by HSBC affiliates, some were. HBUS did not allow such transactions to proceed, showing the effectiveness of the OFAC filter when all appropriate transactions are run through it.

On November 9, 2006, for example, “at the direction of OFAC,” HBUS blocked for further review a \$32,000 payment that had been originated by HBME, because the underlying payment details indicated the funds were to be credited to Al Aqsa Islamic Bank.<sup>1012</sup> This bank had been designated as a “specially designated global terrorist” by OFAC in December 2001, because it was a “direct arm of Hamas, established and used to do Hamas business.”<sup>1013</sup> On November 20, 2006, HBME asked HBUS to cancel the payment, because “it was sent in error.” On December 7, 2006, however, OFAC instructed HBUS to continue to block the funds. HBUS AML Compliance head Teresa Pesce wrote: “How is it that these payments continue to be processed by our affiliates in light of the GCLs?”<sup>1014</sup>

A report prepared by Deloitte at HBUS’ request, examining the period 2001 to 2007, also disclosed that one U.S. dollar correspondent account located in the United Kingdom had been opened for a bank located in Syria, while two U.S. dollar correspondent accounts in the United Kingdom had been established for the “Taliban.”<sup>1015</sup> When asked about the correspondent account for a bank established for the Taliban, HSBC legal counsel told the Subcommittee that HBEU had maintained an account for Afghan National Credit and Finance Limited, the London subsidiary of an Afghan bank that, from October 22, 1999 to

<sup>1011</sup> See 2007 Deloitte OFAC review, “Results of the Transactions Review-UK Gateway, March 29, 2012,” HSBC-PSI-PROD-0197919-989, at 988; Subcommittee briefing provided by Deloitte representatives (5/5/2012).

<sup>1012</sup> 12/14/2006 email from HBUS Elizabeth Protomastro to HBUS John Allison and others, “OFAC – Wire payments blocked from HSBC offshore entities – USD 32,000 (re SDGT) and USD 2,538,939.33 (re Sudan),” HSBC OCC 3407608-609.

<sup>1013</sup> 1/9/2007 email from HBUS Elizabeth Protomastro to HSBC John Allison, HBUS Teresa Pesce, Anne Liddy, and others, “OFAC – Wire payments blocked from HSBC offshore entities – USD 32,000 (re SDGT) and USD 2,538,939.33 (re Sudan),” OCC-PSI-00610498, at 2.

<sup>1014</sup> See 12/15/2006 email from HBUS Teresa Pesce to HBUS Elizabeth Protomastro and others, “OFAC – Wire payments blocked from HSBC offshore entities – USD 32,000 (re SDGT) and USD 2,538,939.33 (re Sudan),” HSBC OCC 3407608.

<sup>1015</sup> 10/18-10/19/2011 “Transaction Review Progress and Results Reporting,” prepared by Deloitte LLP, HSBC-PSI-PROD-0096628-672, at 649.

February 2, 2002, was designated under OFAC's Taliban sanctions.<sup>1016</sup> An HBUS representative told the Subcommittee that HBUS was unable to go back far enough in its records to uncover whether or not the Afghan account at HBEU sent transactions through HBUS during that time.<sup>1017</sup> The fact that HBEU had this account after the 9/11 terrorist attack on the United States again demonstrates how HSBC affiliates took on high risk accounts that exposed the U.S. financial system to money laundering and terrorist financing risks. These U.S. dollar accounts may also have contravened the 2005 GCL and OFAC regulations by enabling banks in Syria and Afghanistan when it was controlled by the Taliban to engage in U.S. dollar transactions through HBUS.

Another account involving an individual on the OFAC list was housed at HSBC Cayman Islands. On February 21, 2008, a Syrian businessman by the name of Rami Makhoulf was placed on the SDN list by OFAC.<sup>1018</sup> One week later, HSBC Cayman Compliance personnel contacted HBUS to report that HSBC Cayman Islands currently held a trust relationship with Mr. Makhoulf and to inquire as to "what actions if any HSBC Group has taken in relation to the above mentioned individual."<sup>1019</sup> An HBUS Compliance officer asked the Cayman Compliance officer for more information about the Makhoulf accounts, and the head of HSBC Cayman Compliance responded: "The Trust is administered by HSBC Geneva. We raised concerns with this client in August 2007 however we were assured by David Ford that the relationship had been reviewed at a Group level and a decision had been taken to continue with the relationship."<sup>1020</sup> Ultimately, HBUS determined that it did not have any connection to Mr. Makhoulf and did not need to report any information to OFAC.

### (3) HBUS' OFAC Compliance Program

Internal bank documentation related to HBUS' OFAC compliance efforts regarding OFAC sensitive transactions portrays a variety of specific problems over the period reviewed by the Subcommittee. One problem was that some HSBC affiliates continued to offer U.S. dollar

<sup>1016</sup> Subcommittee briefing by HSBC legal counsel (7/9/2012). See also "UK Observer Reports Taliban Banks Still Operating in London," *London The Observer*, Sunday edition of *The Guardian* (10/1/2007); "Schwerer Schlag": Ein kleines Geldhaus in London diente offenbar als Hausbank der Taliban," [Serious Blow: A small Financial Institution in London apparently served as Taliban's main bank"], *Der Spiegel*, Christoph Von Pauly (10/8/2001).

<sup>1017</sup> Id.

<sup>1018</sup> See 2/21/2008 U.S. Department of Treasury Press Release No. HP-834, "Rami Makhoulf Designated For Benefiting from Syrian Corruption," <http://www.treasury.gov/press-center/press-releases/Pages/hp834.aspx> ("The U.S. Department of the Treasury today designated Rami Makhoulf, a powerful Syrian businessman and regime insider whom improperly benefits from and aids the public corruption of Syrian regime officials.").

<sup>1019</sup> 2/28/2008 email exchange among HBUS Andy Im and HSBC Cayman Islands Patricia Dacosta and Michelle Williams, HSBC OCC 8878838-840.

<sup>1020</sup> Id.

accounts to prohibited persons despite HSBC Group policy and OFAC regulations, and continued to send transactions involving those accounts through their U.S. dollar accounts at HBUS. A second problem was the ongoing practice by some HSBC affiliates and others to use methods of processing transactions which did not disclose the participation of a prohibited person or country when sending a transaction through an account at HBUS. Even some within HSBC worried that such methods would look deceptive to its U.S. regulators. In other cases, prohibited transactions were not detected by HSBC's WOLF filter or HBUS' OFAC filter due to programming deficiencies that did not identify certain terms or names as suspicious. In still other cases, transactions that had been properly blocked by the WOLF or OFAC filter were released by HSBC or HBUS employees in error, due to rushed procedures, inadequate training, or outright mistakes. Beginning in 2008, spurred in part by an upcoming OCC examination of its OFAC compliance program, HBUS took a closer look at its program as a whole.

On September 28, 2008, HBUS received a cautionary letter from OFAC regarding "12 payments processed from September 4, 2003 through February 1, 2008 which represent possible violations against U.S. economic sanctions."<sup>1021</sup> That same month, HBUS learned that the OCC planned to review its OFAC operations as part of a November 2008 examination of HBUS' Payments and Cash Management (PCM) division.<sup>1022</sup> In response, HBUS undertook a detailed analysis of not only the 12 transactions highlighted by OFAC, but also other prohibited transactions that had been processed through the bank since issuance of the 2005 GCL policy.

On October 3, 2008, a member of HBUS' OFAC Compliance team Elizabeth Protomastro forwarded the OFAC letter to HBUS Compliance head Leslie Midzain.<sup>1023</sup> Ms. Midzain, in turn, forwarded it to HSBC Group Compliance head David Bagley and HNAH's regional Compliance head Janet Burak.<sup>1024</sup> Ms. Midzain wrote that she was giving them an "immediate heads up" because of the "additional [OFAC] failures since February 2008," the upcoming OCC examination in November, and the "continued sensitivity" surrounding OFAC compliance. She stated that the matter would "receive high priority."<sup>1025</sup>

<sup>1021</sup> 9/29/2009 OFAC Cautionary Letter, HSBC-PSI-PROD-0096180-181.

<sup>1022</sup> See 10/3/2008 email from HBUS Lesley Midzain to HBUS Janet Burak, HSBC David Bagley, and HBUS Anne Liddy, "OFAC 'Cautionary Letter' received today," HSBC OCC 3406951-952.

<sup>1023</sup> Emails between HBUS Elizabeth Protomastro, HBUS Lesley Midzain, and others on October 3, 2008, "OFAC 'Cautionary Letter' received today," HSBC OCC 3406952-953.

<sup>1024</sup> 10/3/2008 email from HBUS Lesley Midzain to HBUS Janet Burak, HSBC David Bagley, and HBUS Anne Liddy, "OFAC 'Cautionary Letter' received today," HSBC OCC 3406951-952.

<sup>1025</sup> Id.

On November 6, 2008, Ms. Midzain provided Mr. Bagley and Ms. Burak with detailed charts on the 12 prohibited transactions as well as a larger number of prohibited transactions that had been mistakenly processed by the bank.<sup>1026</sup> To provide context to the figures, she noted that HBUS processed approximately 600,000 wire transfers per week, of which about 5%, or 30,000 transactions, generated “possible [OFAC] matches which require review prior to releasing.”<sup>1027</sup> She wrote that, over a five-year period from 2003 to 2008, HBUS had “rejected and reported 1,212 transactions valued at \$100 million” to OFAC.<sup>1028</sup> She explained that, in addition, HBUS had self-reported 79 missed transactions to OFAC that should have been blocked, but weren’t. Of those, she wrote that HBUS had identified “approx[imately] 57” that were issued subsequent to the 2005 GCL that were “contrary to sanction requirements and for which HSBC was the originating bank.”<sup>1029</sup> She noted that some of the issues had arisen after HBUS replaced its OFAC filter in July 2007, and may have been due to gaps in the filter that were closed “as the system [was] refined.”<sup>1030</sup>

Ms. Midzain reported that the 79 missed transactions primarily involved Iran and Sudan.<sup>1031</sup> Other transactions involved Cuba, Iraq, Syria, Zimbabwe, and persons on the SDN list. Ms. Midzain explained that of the 57 missed transactions that occurred since issuance of the July 2005 GCL policy barring HSBC affiliates from processing U.S. dollar transactions for OFAC sensitive persons, 21 or about one-third had nevertheless originated with an HSBC affiliate.<sup>1032</sup> Of those 21, her analysis noted that about five did not contain a reference to a prohibited person. Her analysis suggests that an HSBC affiliate may have been using a cover payment which would mask the nature of the transaction from HBUS.<sup>1033</sup> Ms. Midzain wrote: “Regarding Group members, since Group policy was issued JUL05, we have nonetheless received a fairly notable number of payments that suggest HSBC banks have not been consistently applying the policy.”<sup>1034</sup> She also noted that the analysis had not examined the population of payments that HBUS stopped over the years to see how many of them also came from HSBC affiliates. Her figures also did not reflect the larger universe of potentially prohibited transactions that were processed by the bank without either HBUS or OFAC detecting them.

<sup>1026</sup> 11/6/2008 email exchanges among HBUS Leslie Midzain, HSBC David Bagley, HBUS Janet Burak, and others, “OFAC analysis,” HSBC OCC 0616010-026.

<sup>1027</sup> Id. at 012.

<sup>1028</sup> Id.

<sup>1029</sup> Id. at 016.

<sup>1030</sup> Id. at 014.

<sup>1031</sup> Id. at 016-017.

<sup>1032</sup> Id. at 017.

<sup>1033</sup> Id. at 016.

<sup>1034</sup> Id.

David Bagley, HSBC Group Compliance head, thanked Ms. Midzain for her analysis. He also wrote:

“As you know, we have just completed and are currently collating the results of a Groupwide Compliance review of compliance with our USD/OFAC policy.

Whilst some of these apparent breaches of Group policy may be rather historic nevertheless I am determined that we should enforce our policy on a consistent and Groupwide basis.

Given this, what I would like to do is at Group level track back relevant and apparently offending payments and establish root causes so as to satisfy ourselves that there can be no, or at the very least, far less repetition. It is of course unrealistic to expect that no payments will pass through to HBUS, and at least our move to transparency in form of serial payments should allow these to be caught nevertheless I would prefer that payments were rejected at point of entry.”<sup>1035</sup>

The OCC examination took place near the end of 2008. It tested the bank’s OFAC systems to determine if OFAC screening was being properly applied to new accounts, wire transfers, and other transactions.<sup>1036</sup> An internal OCC memorandum stated that, as of June 30, 2008, “HBUS reported 370 items on the OFAC blocked report, valuing approximately \$20 million.” It reported that, from September 2003 to September 2008, HBUS had “rejected and reported to OFAC over 1,200 transactions valuing \$100 million.”<sup>1037</sup> The memorandum also stated that HBUS was then processing about 600,000 wire transfers per week, of which 6%, or about 30,000, were manually reviewed each week by four-person OFAC Compliance teams in Delaware and New York. The OCC wrote that, of the wire transfers that underwent manual review, 20 to 30 per day were “escalated” and required a “disposition decision from compliance management.”<sup>1038</sup> The OCC memorandum reported:

“Although, according to management, within the past five years (9/03-9/08) there ha[ve] been only 80 missed payments, the bank’s Compliance teams are under rigorous pressure to process alerts and determin[e] a disposition in a timely maner. ... [T]his strain can and will inhibit their mental capacity leaving gaps for errors even

<sup>1035</sup> 11/11/2008 email from HSBC David Bagley to HBUS Leslie Midzain and HSBC Susan Wright, “OFAC,” HSBC OCC 0616010-011.

<sup>1036</sup> 7/28/2008 OCC memorandum, “OFAC Examination – Payment and Cash Management (PCM),” OCC-PSI-01274962. [Sealed Exhibit.]

<sup>1037</sup> Id. at 3.

<sup>1038</sup> Id. at 4-5.

though permanent current staff members are well trained and qualified to complete the OFAC responsibilities.”

On January 20, 2009, the OCC sent HBUS a Supervisory Letter with generally positive examination findings regarding its OFAC compliance efforts.<sup>1039</sup> The Supervisory Letter stated:

- “• OFAC Compliance is **High and Increasing**. The quality of risk management systems is satisfactory.
- Compliance with legal and regulatory requirements is satisfactory and no violations of law or regulation were cited at this examination.
- One recommendation is made related to staffing.”<sup>1040</sup>

The Supervisory Letter stated that the OFAC risk was high and increasing due to “almost a zero tolerance for error” under OFAC regulations and increasing growth in HBUS’ PCM and retail banking businesses. The staffing recommendation, which did not require corrective action, stated: “Management should consider a review of current staffing requirements to ensure that there is an adequate number of permanent qualified staff to prolong the timely operations associated with OFAC related matters and to ensure adherence with regulatory requirements . . . as your business grows.”<sup>1041</sup> Despite the OCC’s generally positive examination, internal bank documents indicate that HBUS itself had a much more negative view of its OFAC compliance program. In June 2009, HBUS initiated an “OFAC Program Review Project.”<sup>1042</sup> Four months later, in October 2009, Debra Bonosconi, the HBUS Director for Specialized Compliance overseeing the Embassy Banking business, sent an email to Anthony Gibbs, the COO of HSBC North America Legal and Compliance, commenting on a number of compliance issues, including OFAC compliance.<sup>1043</sup> Ms. Bonosconi, who had begun working at HBUS in March 2008, wrote that she had only recently become aware of the negative findings of the OFAC Program Review Project. She explained:

“This project has been underway since June and the findings that have surfaced are no different than those already identified previously. So, we have a project that has taken far longer than it should have and findings that do not vary significantly from previous reviews.

<sup>1039</sup> See OCC Supervisory Letter HSBC-2008-41, “Office of Foreign Asset Control Examination,” OCC-PSI-00000434-436. [Sealed Exhibit.]

<sup>1040</sup> Id. at 1.

<sup>1041</sup> Id. at 3.

<sup>1042</sup> See 10/23/2009 email from HBUS Debra Bonosconi to HBUS Anthony Gibbs, “comments,” HSBC OCC 3405534-537.

<sup>1043</sup> Id.

The bottom line is, our OFAC process is in disarray and in great risk of being noncompliant. We have multiple systems, inconsistent practices, limited communication between the various functions, and no oversight function.”<sup>1044</sup>

This candid description of the bank’s OFAC compliance program, as having “inconsistent practices,” “limited communication,” and “no oversight function,” stands in marked contrast to the OCC findings less than a year earlier.

Another sign of the stresses in the OFAC compliance program surfaced in December 2009, when the four-person OFAC Compliance team in New York faced an accumulated backlog of greater than 700 OFAC alerts that had yet to be reviewed.<sup>1045</sup> The OFAC Compliance team requested five or six people from the Payments and Cash Management (PCM) department for ten days to help clear the backlog.<sup>1046</sup> PCM responded that it had no resources to loan, and suggested asking Compliance personnel in Delaware for help. The OFAC Compliance team in New York responded that the Delaware Compliance staff was already “fully deployed” dealing with general alerts from the CAMP monitoring system:

“We have considered all options at this point[;] the Compliance team in DE is already fully deployed dealing with wire camp alerts and bank examiner requests for the current exam. There is no bandwidth there at all[;] they are behind on the current alert clearing process which we are also dealing with.”<sup>1047</sup>

In late 2011, the OCC conducted a second examination of HBUS’ OFAC compliance program and, on January 25, 2012, issued a Supervisory Letter with a more negative assessment.<sup>1048</sup> The Supervisory Letter stated that the OCC was “concerned about the number and severity of the deficiencies in the enterprise-wide OFAC compliance program” at HBUS and at two other HSBC affiliates in the United States, HSBC Nevada, N.A. and HSBC Trust Company (Delaware), N.A. It stated that the OCC had reviewed reports prepared by HBUS’ own auditors and by an outside consultant that “identified significant deficiencies in the program.” It noted that bank management had taken “significant steps” to address deficiencies, but concluded the

<sup>1044</sup> Id. at 537.

<sup>1045</sup> 12/11/2009 email exchange among HBUS Camillus Hughes and HBUS Michael Gallagher, Charles DelBusto, Sandra Peterson, Thomas Halpin, Chris Davies, and Lesley Midzain, “OFAC Payments,” HSBC OCC 7688668-670, at 670.

<sup>1046</sup> Id.

<sup>1047</sup> Id. at 668.

<sup>1048</sup> See 1/25/2012 OCC Supervisory Letter HSBC-2012-03, “OFAC Compliance Program,” OCC-PSI-01768561-566. [Sealed Exhibit.]



“three banks lack a robust OFAC risk assessment that ensures the OFAC risks have been adequately identified so they can be managed appropriately.” The Supervisory Letter contained two Matters Requiring Attention (MRAs) by the bank: (1) development of a “comprehensive OFAC risk assessment;” and (2) an independent review of certain real estate loans through a California branch between 2009 and 2011, involving Iran, that raised OFAC concerns.<sup>1049</sup> The Supervisory Letter also included a three-page attachment identifying OFAC violations cited in seven OFAC cautionary letters since June 2009. The OCC required HBUS to modify the AML action plan it was developing in response to a September 2010 Supervisory Letter necessitating broad improvements in its AML program to include the MRAs on its OFAC compliance program.<sup>1050</sup>

Since the OCC examination, OFAC has issued one more cautionary letter to HBUS. Altogether, six of the pending OFAC letters warned that the violations might result in a civil monetary penalty, but no penalty has been imposed as of June 2012.

#### (4) Server Issues

One additional issue involving OFAC-sensitive transactions involves payment messages associated with non-U.S. dollar transactions that were sent through servers physically located in the United States, but which were not processed by HBUS and were not screened by an OFAC filter. The key issue is whether the electronic presence of those payment messages in the United States, utilizing U.S. facilities on their way elsewhere, required application of the OFAC filter.<sup>1051</sup> Despite concern expressed by HBUS, the bank decided not to turn on the HBUS OFAC filter to screen these payment messages.

**WHIRL Server.** In the documents reviewed by the Subcommittee, server issues appear to have first arisen in 2003, when the HSBC Group Executive Committee discussed establishing a new server in the United Kingdom to process credit card transactions, instead of continuing to route those transactions through a server in the United States, for the express purpose of “avoid[ing] contravening the OFAC restrictions.”<sup>1052</sup> In January 2004, the HSBC Group Board of Directors approved installing a separate, so-called “WHIRL system” in the United Kingdom at an estimated cost of \$20 million.<sup>1053</sup> When asked about the

<sup>1049</sup> Id. at 2.

<sup>1050</sup> Id. at 3.

<sup>1051</sup> When asked, OFAC declined to provide a definitive answer to the Subcommittee in the abstract, indicating that its analysis would have to examine specific facts. Subcommittee briefing by OFAC (5/8/2012).

<sup>1052</sup> See 1/30/2004 Board of Directors minutes for HSBC Holdings plc, HSBC-PSI-PROD-0198571-572. The HSBC Group Executive Committee consisted of senior executives in HSBC.

<sup>1053</sup> See 1/30/2004 Board of Directors minutes for HSBC Holdings plc, HSBC-PSI-PROD-0198571-572.

WHIRL server, Mr. Bagley told the Subcommittee that the bank had moved the payment processing outside of the United States to protect HBUS, that he viewed it as a broad reading of OFAC rules at the time, and that he saw it as a conservative decision.<sup>1054</sup>

By 2005, the WHIRL server was active. In November 2005, Mr. Bagley asked Mr. Root to follow up on certain HBMX compliance issues identified by Mexican regulators, including the processing of credit card transactions. Mr. Bagley wrote that even through the credit card transactions “are, or will be processed on the UK Whirl server the routing of the relevant messages may pass through the U.S. first.”<sup>1055</sup> He also wrote: “If this is the case then we may still have an issue dependent on how much intervention is theoretically possible on the part of the US leg.” The following day, the head of HBMX Compliance Ramon Garcia informed Mr. Root and Mr. Bagley that WHIRL transaction messages were still being routed through a U.S. server “for a fraction of a second for later transfer to the UK,” which could be long enough for a “log file” to exist in the United States identifying the transactions.

**HSBC Affiliates in the Americas.** Six months later, in April 2006, Mr. Bagley proposed that “countries in the Americas outside USA disconnect their payment routing link to the USA TP Gateway and reconnect to the UK TP.” He indicated doing so would provide two main benefits: “firstly the ability to make payments in currencies other than USD to countries/names/entities sanctioned by USA OFAC (as permitted by GCL 050047), and secondly to take data records outside USA.”<sup>1056</sup> His email raised the issue of whether electronic payment messages routed through a U.S. server could be subject to HBUS’ OFAC filter and the obligation to block all potentially prohibited transactions.

In November 2006, at a meeting of the HBUS Compliance Risk Management Committee, then HBUS Compliance head Teresa Pesce advised: “Plans are underway to implement OFAC screening for messages sent by the Americas through the global messaging gateway in the US in 2007.”<sup>1057</sup> Her decision to inform the committee of that development indicates that payment messages already being routed through the U.S. server were not being scanned against the OFAC filter. If the OFAC filter was not being used, all of the payment messages being sent through the United States by HSBC affiliates in Latin

<sup>1054</sup> Subcommittee interview of David Bagley (5/10/2012).

<sup>1055</sup> See 11/15-22/2005 email exchanges among HSBC David Bagley, HSBC John Root, and HBMX Ramon Garcia, “HBMX – Compliance Issues,” HSBC OCC 8873261-266.

<sup>1056</sup> 4/10/2006 email from HSBC David Bagley to HBRR Luis Eduardo, HBMX David Leighton, and others, “TP Gateways,” HSBC OCC 7687437-438.

<sup>1057</sup> 11/13/2006 Compliance Risk Management Committee minutes for HBUS, HSBC OCC 3407449-451.

America were not being screened for terrorists, drug traffickers, or other wrongdoers.

Four months later, in March 2007, Mr. Bagley contacted Alexander Flockhart, then HSBC Latin America CEO, about Latin America payment messages being routed through the U.S. server, in light of the increased focus on OFAC compliance “on the part of both OFAC” and “our banking regulators.”<sup>1058</sup> Mr. Bagley noted that HBUS was required to screen all transactions for compliance with OFAC requirements, including all non-U.S. dollar transactions, which “would clearly be disadvantageous from Latin America’s perspective,” since the logistics of screening all those transactions “would be commercially and operationally challenging” for Latin American affiliates. Mr. Bagley informed Mr. Flockhart that they were developing a stand-alone WHIRL server in the United Kingdom that Latin America could use and which would avoid OFAC screening. He commented that if Mr. Flockhart “want[ed] to carry out as many transactions permitted by Group policy as possible,” he should relocate Latin America’s payment processing “to a different Group Messaging Gateway” than the one in the United States.

Mr. Bagley also noted that HSBC Group had already “informally explored” the possible relocation of Latin America payment processing to the U.K. server, but realized that gateway was already experiencing capacity issues. Mr. Bagley commented further that the existing situation in which “the filtering” was not turned on was making HSBC’s U.S. colleagues “extremely uncomfortable”:

“Whilst we have lived with the current position for some time, it is fair to say that now that our US colleagues are on notice they feel extremely uncomfortable in allowing the position to continue indefinitely. In essence, we will either have to have a pass and timeline for a relocation of the payment messages or will need to turn the filtering on.”<sup>1059</sup>

Mr. Bagley does not make it clear how his U.S. colleagues were put “on notice,” and when asked, he told the Subcommittee that he did not recall who he talked with at HBUS about the issue, but he did indicate clearly that the OFAC filter was not turned on for the U.S. server being used to forward payment messaging traffic from HSBC affiliates in Latin America.<sup>1060</sup> Five months earlier, HBUS Compliance head Teresa Pesce told the HBUS Compliance Risk Management Committee that payment messages sent by the Americas through the

<sup>1058</sup> 3/13/2007 email from HSBC David Bagley to HBMX Sandy Flockhart, “Group Messaging,” HSBC OCC 8874354-355.

<sup>1059</sup> Id. at 355.

<sup>1060</sup> Subcommittee interview of David Bagley (5/10/2012).

U.S. gateway would be scanned for OFAC beginning in 2007; Mr. Bagley's email indicates that, as of March 2007, the OFAC filter had still not been turned on, and his U.S. colleagues were "extremely uncomfortable in allowing the position to continue indefinitely."

The following day Mr. Flockhart asked for a contact to discuss re-routing Latin American payment messaging traffic through the U.K. server. A few days after that, Mr. Bagley provided the contact information and also notified Mr. Flockhart that HSBC Brazil was considering "giving up certain payments activity given the challenges of passing that activity through the US."<sup>1061</sup> Mr. Bagley wrote that the HSBC Group had asked HSBC Brazil to postpone that decision until it was determined whether payment messaging could be "migrated elsewhere." Mr. Bagley also wrote: "There may also need to be a conversation at some stage with Paul Lawrence [then HBUS CEO] if it is necessary to persuade HBUS to continue with payment messaging pending any migration."<sup>1062</sup> In this email, the head of HSBC Group Compliance seems to be advocating sending non-U.S. dollar payments through the U.S. gateway without monitoring the transactions for OFAC compliance, pending migration of the Latin American traffic to another server. When Paul Thurston, former head of HBMX, was asked about Mr. Bagley's comments, he expressed surprise that the HSBC Group Compliance head took that position.<sup>1063</sup> In June 2007, Mr. Flockhart approved switching Latin America's non-U.S. based SWIFT traffic to the U.K. gateway citing it as the most cost effective solution.<sup>1064</sup>

Around the same time, HSBC Brazil (HBBR) also sought to move its transactions from the U.S. to the U.K. server to avoid the OFAC filter. In December 2006, HBBR contacted Malcolm Eastwood at HBEU, asking for assistance in obtaining a second SWIFT address to be used for HBBR payments going to Iran, Cuba, and other sanctioned countries. HBBR explained that these transactions – about 50 per year – were compliant with Group policy, but ran the risk of being blocked by the U.S. server they currently utilized, which was why it wanted to switch the transactions to the U.K. server and execute them in Euros. HBBR wrote: "To enable it, we have been informed that we have to create a second SWIFT address (BIC) to be used exclusively for this

<sup>1061</sup> 3/22/2007 email from HSBC David Bagley to HBMX Sandy Flockhart, "Group Messaging," HSBC OCC 8875066-067.

<sup>1062</sup> *Id.*

<sup>1063</sup> Subcommittee interview of Paul Thurston (5/1/2012). Mr. Bagley said that the reason he suggested to Mr. Flockhart that the messages be moved to the U.K. gateway was because he had received a legal opinion, which he considered "extreme," that non-U.S. dollar messages going through a U.S. messaging center could be impacted by OFAC. He was, thus, acting in a conservative manner to avoid violating OFAC requirements. Subcommittee interview of David Bagley (5/10/2012).

<sup>1064</sup> 6/1/2007 email from HBMX Sandy Flockhart to HBMX Neelesh Heredia and others, "Group Messaging Gateway for LAM – Clear Choice Report," HSBC OCC 8874349-350.

purpose, which should also not be published by SWIFT in their books.”<sup>1065</sup>

In response, Mr. Eastwood reached out to HSBC Group Compliance and HBEU operational staff to discuss practical issues with Brazil’s routing “US sanctioned items” via the U.K. server. He wrote: “I have concerns that we might be breaching at least the spirit of the US Serial Routing GCL if not the letter of it.”<sup>1066</sup> HSBC Group Money Laundering Control Officer John Allison responded that, by using the U.S. server, Brazil was subject to an “all currency prohibition for all OFAC entries,” but HSBC Group policy allowed Brazil to make payments in non-U.S. dollar currencies to entities on the OFAC list, so long as they were not linked to terrorism or weapons of mass destruction. At the same time, he expressed concern about the perception of HSBC’s obtaining an additional SWIFT address dedicated to payments intended for OFAC sanctioned countries.

Mr. Eastwood forwarded this email correspondence to HBEU colleagues with the comment: “Just fyi. This all makes me very nervous!” HBEU’s Rod Moxley responded that trying to identify and process transactions “which have so many conditions attached to them” was a predicament for them. He wrote: “Slightly irritating too that GHQ CMP [Group Headquarters Compliance] seem to have bent over backwards to accommodate a system which looks very dodgy to me. How about no you can’t do this?”<sup>1067</sup> On January 2, 2007, Mr. Moxley sarcastically described setting up a second SWIFT address an “interesting concept,” forwarded the idea to a colleague, and wrote: “let’s set up a completely different Swift address to help avoid any problems with Cuba and Iran. Wish I’d thought of it.”<sup>1068</sup>

On January 26, 2007, Mr. Eastwood responded to Brazil’s request.<sup>1069</sup> He indicated in a memorandum that, after conferring with HSBC Group Compliance and operational personnel, they were not favorable to segregating certain transactions through separate SWIFT addresses, even though the transactions were permissible under Group policy, due to the possible perception of “taking action to avoid certain transactions being examined by the US authorities.” Instead, Mr. Eastwood noted that HBBR could re-route all of its SWIFT traffic via

<sup>1065</sup> 12/18/2006 email from HBBR Morgana Casagrande to HBEU Malcolm Eastwood and others, “Transactions with Iran/Cuba, etc.,” HSBC OCC 8876927-928.

<sup>1066</sup> 12/21/2006 email from HBEU Malcolm Eastwood to Bill Rice and others, “Fw: Transactions with Iran/Cuba, etc.,” HSBC OCC 8876927.

<sup>1067</sup> See 12/28/2006 - 1/4/2007 email exchanges among HBEU Malcolm Eastwood, HSBC John Allison, HBEU Rod Moxley, and others, “Transactions with Iran/Cuba, etc.,” HSBC OCC 8876925-927.

<sup>1068</sup> 1/2/2007 email from HBEU Rod Moxley to HBEU Andy Newman, “Transactions with Iran/Cuba, etc.,” HSBC OCC 8876921.

<sup>1069</sup> 1/26/2007 memorandum from HBEU Malcolm Eastwood to HBBR Lucas Fragoso and others, “Trade Transaction with Iran/Cuba etc.,” HSBC OCC 8876930-931.

the U.K. server, listing several logistical issues that would have to be resolved if Brazil wanted to move forward.

These documents raise the question of whether non-U.S. dollar payment messages referencing transactions routed through a U.S. server by HSBC affiliates were required to be screened by an OFAC filter, or whether they could move across U.S. boundaries and use U.S. facilities without triggering any OFAC prohibitions. On the one hand, HSBC Group Compliance urged Latin America to switch their messaging traffic from a U.S. to a U.K. server to avoid the delays that come with OFAC screening, while on the other hand indicating that for at least a five-month period from November 2006 to March 2007, the OFAC filter had not been turned on to screen the Latin American payment messages going through the U.S. server even though HBUS apparently had expressed concerns about not screening the messages for prohibited activity. HSBC Group knowingly put its U.S. affiliate at regulatory and reputational risk by moving payment messages through a U.S. server without scanning them against the OFAC filter.

**Turning Off OFAC Verification.** A very different server issue arose in July 2007, when HBUS introduced a new product called Fircosoft to help monitor OFAC sensitive transactions. The product caused a huge increase in the number of OFAC alerts, creating a backlog that began to overwhelm HBUS OFAC compliance personnel. According to a fourth quarter 2007 Compliance Report by HBUS, the introduction of the new product caused “serious performance issues” that would “not support HBUS volumes.”<sup>1070</sup> On July 17, 2007, “a risk based decision was made to eliminate the verification step of all OFAC filter alerts on a temporary basis to accelerate the process of clearing the OFAC queue.”<sup>1071</sup> The more limited review process for OFAC sensitive transactions remained in effect for about three weeks, from July 17 to August 6. On August 1, 2007, HBUS Chief Operating Officer David Dew wrote: “I think that we simply must now agree on a definitive timetable for reintroduction of full OFAC controls.”<sup>1072</sup> When asked about this matter, Mr. Dew told the Subcommittee that he thought the limitation on the “verification step” in the OFAC filter was only stopped for about a day.<sup>1073</sup> Anne Liddy told Subcommittee that she recalled that the verification step was turned off for about a month, but didn’t view it as a risk to the bank.<sup>1074</sup>

<sup>1070</sup> 4Q07 Compliance Report from HBUS Carolyn Wind to HNAH Janet Burak and others, HSBC-PSI-PROD-0000508-016, at 509.

<sup>1071</sup> Global Payments System (GPS) Implementation Issues, 6 Aug 07 HUSI Audit Committee Update, HSBC OCC 1105891.

<sup>1072</sup> 8/01/2007 email from HBUS David Dew to Bandula Wijesinghe and others, OCC-PSI-00188404.

<sup>1073</sup> Subcommittee interview of David Dew (3/05/2012).

<sup>1074</sup> Subcommittee interview of Anne Liddy (2/22/2012).

In 2009, the same verification step in the OFAC filter was again turned off by HBUS for a few weeks. In November 2009, due to an industry-wide switch to SWIFT202 cover payments, OFAC alerts increased dramatically at HBUS. HBUS was so concerned about the large number of false OFAC hits being generated that it stopped the verification step, as was done in 2007. Turning off the verification step concerned one HBUS employee enough that the employee quietly reported the action to the Federal Reserve. The Federal Reserve examiner who spoke with the employee wrote in an email to colleagues the following:

“On Monday Lesley Midzain, former head of BSA/AML turned off the second level filter on Chips activity without consulting anyone and with no supporting documentation. The rationale given for turning the second level filter off was to reduce the daily backlog in lieu of additional resources. The individual who spoke to me knew this was not appropriate action and decided to call the [regulator].”<sup>1075</sup>

HSBC’s legal counsel told the Subcommittee that the verification step was turned off for 13 days, from November 25, 2009 to December 7, 2009.<sup>1076</sup> The issue raised by both incidents in 2007 and 2009, is whether HBUS’ decision to turn off part of the OFAC filtering system reduced its effectiveness in screening for prohibited transactions and increased U.S. vulnerabilities to money laundering and terrorist financing.

### C. Analysis

OFAC enforces U.S. programs aimed at exposing and disabling the financial dealings and resources of some of the most dangerous persons and jurisdictions threatening the world today, including terrorists, persons involved with weapons of mass destruction, drug traffickers, and rogue jurisdictions. The OFAC filter is the central mechanism used to identify, stop, and block suspect transactions speeding through financial systems. Global financial institutions have a special responsibility to respect OFAC prohibitions and comply with OFAC restrictions. Actions taken to circumvent the OFAC filter or endanger the effectiveness of a critical safeguard may facilitate transactions undertaken by some of the worst wrongdoers among us.

The evidence reviewed by the Subcommittee indicates that, from 2001 to 2007, HSBC affiliates, with the knowledge and tacit approval of HSBC Group executives, engaged in alarming conduct sending undisclosed Iranian U-turn transactions through their HBUS

<sup>1075</sup> 12/16/2009 internal Federal Reserve memorandum, BOG-A-207130. [Sealed Exhibit.]

<sup>1076</sup> Subcommittee briefing by HSBC legal counsel (6/27/2012).

correspondent accounts, without information that would otherwise have triggered OFAC reviews. When asked, HBUS insisted on HSBC affiliates using transparent payment instructions so that all U-turn transactions would be stopped by the OFAC filter and reviewed, but when faced with evidence that some HSBC affiliates were acting to circumvent the OFAC filter, HBUS failed to take decisive action to stop the conduct some in its own organization viewed as deceptive. In addition, from at least 2009 to early 2012, the bank's OFAC compliance program suffered from multiple deficiencies. Still another issue is that some HSBC affiliates sent non-U.S. dollar messaging traffic through U.S. servers in which the OFAC screening was not turned on or was restricted.

The aim in many of the instances in which HSBC affiliates acted to circumvent the OFAC filter may have been to avoid the time-consuming individualized reviews that followed, rather than execute prohibited transactions. But expediency in the face of the threats posed by the targets of OFAC prohibitions does not justify potentially violating or undermining OFAC requirements. HBUS likewise failed to obtain information about the full scope of undisclosed OFAC sensitive transactions going through its correspondent accounts, bring to a head the issue of HSBC affiliates circumventing OFAC safeguards, and ensure all transactions were reviewed for OFAC compliance.



## V. AL RAJHI BANK: DISREGARDING LINKS TO TERRORIST FINANCING

For decades, HSBC has been one of the most active global banks in Saudi Arabia, despite AML and terrorist financing risks involved with doing business in that country. Among other activities, for more than 25 years, HSBC has provided a wide range of banking services to Al Rajhi Bank, Saudi Arabia's largest private bank.<sup>1077</sup> Those services included providing large amounts of physical U.S. dollars to the bank as part of HSBC's U.S. banknotes business. After the 9/11 terrorist attack on the United States in 2001, evidence began to emerge that Al Rajhi Bank and some of its owners had links to organizations associated with financing terrorism, including that one of the bank's founders was an early financial benefactor of al Qaeda. In January 2005, despite the fact that Al Rajhi Bank had not been indicted, designated a terrorist financier, or sanctioned by any country, HSBC Group Compliance recommended internally that, due to terrorist financing concerns, HSBC affiliates should sever ties with the bank.

In response, some HSBC affiliates disregarded the recommendation and continued to do business with the bank, while others terminated their relationships but protested HSBC's decision and urged HSBC to reverse it. The protests continued despite a U.S. indictment the next month, in February 2005, of two individuals accused, among other matters, of cashing \$130,000 in U.S. travelers cheques at Al Rajhi Bank in Saudi Arabia and smuggling the money to violent extremists in Chechnya. In May 2005, four months after its initial decision, HSBC Group Compliance reversed itself and announced that all HSBC affiliates could do business with Al Rajhi Bank, thus allowing HBUS to decide for itself whether to resume the relationship. For nearly two years, HSBC Banknotes repeatedly asked HBUS AML Compliance personnel to allow reinstatement of the Al Rajhi Bank relationship, despite ongoing concerns at HBUS about the bank's possible links to terrorist financing.

On December 1, 2006, despite concern that there is "no smoke without fire," HBUS AML Compliance agreed to allow HBUS to reinstate the relationship and resume supplying U.S. dollars to Al Rajhi Bank. Earlier, Al Rajhi Bank had threatened to pull all of its business from HSBC if the U.S. banknotes business were not restored, while HSBC personnel estimated that restoring the U.S. banknotes business would produce annual revenues of at least \$100,000. In 2007, additional information surfaced about Al Rajhi Bank's possible links to terrorism,

<sup>1077</sup> HSBC also operates an affiliate, HSBC Bank Middle East, with branches in Saudi Arabia; owns Saudi British Bank; and provides correspondent banking services to other Saudi financial institutions.

including articles on a 2003 report by the U.S. Central Intelligence Agency (CIA) entitled, "Al Rajhi Bank: Conduit for Extremist Finance," which found that "[s]enior al-Rajhi family members have long supported Islamic extremists and probably know that terrorists use their bank." Despite that and other troubling information, HBUS continued to supply U.S. dollars to the bank, and even expanded its business, until 2010, when HSBC decided, on a global basis, to exit the U.S. banknotes business.

Al Rajhi Bank was not the only bank with links to terrorism serviced by HBUS. Two additional examples are Islami Bank Bangladesh Ltd. and Social Islami Bank Ltd. which is also located in Bangladesh. In each case, in anticipation of revenues of \$75,000 to \$100,000 per year, HBUS Banknotes personnel disregarded troubling evidence of possible links to terrorist financing, opened accounts for the banks, and provided them with U.S. dollars and access to the U.S. financial system.

#### A. Al Rajhi Bank

Founded in 1957, Al Rajhi Bank is one of the largest banks in Saudi Arabia, with over 8,400 employees and assets totaling \$59 billion.<sup>1078</sup> Headquartered in Riyadh, the bank has over 500 branches, mostly in Saudi Arabia, but also in Malaysia, Kuwait, and Jordan.<sup>1079</sup> The bank was founded by four brothers, Sulaiman, Saleh, Abdullah, and Mohamed, of the Al Rajhi family, one of the wealthiest in Saudi Arabia.

The bank began as a collection of banking and commercial ventures which, in 1978, joined together as the Al Rajhi Trading and Exchange Company.<sup>1080</sup> In 1987, the company converted to a joint stock company, and two years later renamed itself the Al Rajhi Banking and Investment Corporation.<sup>1081</sup> In 2006, the bank rebranded itself as Al Rajhi Bank.<sup>1082</sup> It is traded on the Saudi Arabian Stock Exchange (Tadawul), and about 45% of its shares are publicly owned.<sup>1083</sup> Al Rajhi family members remain the bank's largest shareholders.<sup>1084</sup>

<sup>1078</sup> Al Rajhi Bank website, "About Us," <http://www.alrajhibank.com.sa/en/about-us/pages/default.aspx>.

<sup>1079</sup> Id.

<sup>1080</sup> Id.; Al Rajhi Bank website, "Our History," <http://www.alrajhibank.com.sa/our-history/index.html>.

<sup>1081</sup> Al Rajhi Bank website, "Our History," <http://www.alrajhibank.com.sa/our-history/index.html>.

<sup>1082</sup> Id. The bank also has various subsidiaries, including Al Rajhi Capital. See Al Rajhi Capital website, <http://www.alrajhi-capital.com/en/Welcome+to+ARFS/Overview/>.

<sup>1083</sup> HBUS "Know Your Customer Profile" of Al Rajhi Banking & Investment Corp. (10/15/2010), HSBC-PSI-PROD-0102310, (hereinafter "2010 HBUS KYC Profile on Al Rajhi Bank"), at 2. About 45% of the bank's shares are publicly traded; the remainder is held primarily by members of the Al Rajhi family. Id. at 3.

<sup>1084</sup> 2010 HBUS KYC Profile on Al Rajhi Bank, at 3.

Al Rajhi Bank offers a wide range of banking services including deposits, loans, investment advice, securities trading, remittances, credit cards, and consumer financing.<sup>1085</sup> All services are offered in conformance with Islamic requirements, including the set aside of funds for “zakat,” which is used for charitable donations. The bank has won a number of awards for its operations in the Middle East.

The bank’s most senior official is Sulaiman bin Abdul Aziz Al Rajhi, who at various times has held the posts of Chief Executive Officer, Managing Director, and Chairman of the Board of Directors.<sup>1086</sup> The bank’s General Manager is Abdullah bin Abdul Aziz Al Rajhi. The board of directors consists of eleven directors, six of whom are Al Rajhi family members: Sulaiman bin Abdul Aziz Al Rajhi, Chairman of the Board; Abdullah bin Abdul Aziz Al Rajhi; Sulaiman bin Saleh Al Rajhi; Mohamed bin Abdullah Al Rajhi; Abdullah bin Sulaiman Al Rajhi; and Bader bin Mohammed Al Rajhi.<sup>1087</sup>

The bank is part of an extensive group of Al Rajhi business and nonprofit ventures, which include companies engaged in money exchange services, commodity trading, real estate, poultry, construction, and pharmaceuticals.<sup>1088</sup> One business which also had an HBUS account was the Al Rajhi Trading Establishment, a money exchange business owned by Abdulrahman Saleh Al Rajhi.<sup>1089</sup> Its HBUS account was closed in 2005, when it merged with seven other businesses to form a new Saudi bank. The largest nonprofit venture in the Al Rajhi group is the SAAR Foundation, which is named after Sulaiman bin Abdul Aziz Al Rajhi, and supports nonprofit and business ventures around the world.<sup>1090</sup> Sulaiman Al Rajhi and his family today have an estimated net worth of nearly \$6 billion.<sup>1091</sup>

The Subcommittee contacted Al Rajhi Bank regarding its relationship to HSBC and the matters addressed in this section, but the

<sup>1085</sup> See Al Rajhi Bank website, <http://www.alrajhibank.com.sa.aspx>.

<sup>1086</sup> See Al Rajhi Bank website, “About Us,” <http://www.alrajhibank.com.sa/en/about-us/pages/board-of-directors.aspx>. See also 2010 HBUS KYC Profile on Al Rajhi Bank, at 3 (describing Sulaiman Abdul Aziz Al Rajhi as Chairman of the Board and Managing Director; Abdullah Sulaiman Al Rajhi as CEO; and Mohammed Lookman Samsudeen as General Manager and Chief Financial Officer).

<sup>1087</sup> Rajhi Bank website, “About Us,” <http://www.alrajhibank.com.sa/en/about-us/pages/board-of-directors.aspx>.

<sup>1088</sup> See, e.g., Sulimin Abdul Aziz Al Rajhi Holding Company website, <http://www.alrajhiholding.com/>.

<sup>1089</sup> See, e.g., March 2002 email chain among HBUS personnel, “Al Rajhi Trading establishment,” OCC-PSI-00381727, at 3; 9/8/2008 HSBC Financial Investigations Group (FIG) report on Al Rajhi Bank, HSBC-PSI-PROD-0102813.

<sup>1090</sup> See “Sulaiman Al-Rajhi’s life a rags to riches story,” Arab News (5/29/2012), <http://www.arabnews.com/?q=economy/sulaiman-al-rajhi%E2%80%99s-life-rags-riches-story>.

<sup>1091</sup> See Profile of Sulaiman Al Rajhi & family (March 2012), *Forbes*, <http://www.forbes.com/profile/sulaiman-al-rajhi/>. See also 2010 HBUS KYC Profile on Al Rajhi Bank at 3 (estimating family worth at \$22.5 billion).

bank has not provided any information in response to the Subcommittee's inquiry.

## **B. Saudi Arabia and Terrorist Financing**

The majority of Al Rajhi Bank's operations take place in Saudi Arabia, which the United States has long identified as a country of concern in the area of terrorist financing.<sup>1092</sup> Following the terrorist attack on the United States on September 11, 2001, the U.S. Government began a decade-long intensive investigation into where and how terrorists obtain funding, repeatedly returning to Saudi Arabia, its banks, and its nationals as a suspected source.

In 2004, the 9/11 Commission charged with investigating the terrorist attack issued a report which found that Osama Bin Laden and al Qaeda had relied on a "financial support network that came to be known as the 'Golden Chain,' put together mainly by financiers in Saudi Arabia and the Persian Gulf states."<sup>1093</sup> The Commission's report explained:

"Al Qaeda appears to have relied on a core group of financial facilitators who raised money from a variety of donors and other fund-raisers, primarily in the Gulf countries and particularly in Saudi Arabia. Some individual donors surely knew, and others did not, the ultimate destination of their donations."<sup>1094</sup>

The Commission report stated: "Saudi Arabia's society was a place where al Qaeda raised money directly from individuals and through charities. It was the society that produced 15 of the 19 hijackers."<sup>1095</sup> The report also stated that it "found no evidence that the Saudi government as an institution or senior Saudi officials individually funded [Al Qaeda],"<sup>1096</sup> and that after terrorist attacks began occurring in Saudi Arabia, a "Saudi crackdown ... ha[d] apparently reduced the funds available to al Qaeda – perhaps drastically – but it is too soon to know if this reduction will last."<sup>1097</sup>

After several major terrorist attacks within its borders in 2003 and 2004, Saudi Arabia took a number of steps to combat terrorist financing. One report to Congress by the Congressional Research Service summarized those actions as follows:

<sup>1092</sup> See, e.g., International Narcotics Control Strategy Reports prepared by the U.S. Department of State, 2003-2012 (identifying Saudi Arabia as a country "of concern" with respect to money laundering and terrorist financing).

<sup>1093</sup> The 9/11 Commission Report: Final Report of the National Commission on Terrorist Attacks upon the United States, (7/22/2004), at 55.

<sup>1094</sup> Id. at 170.

<sup>1095</sup> Id. at 370.

<sup>1096</sup> Id. at 171.

<sup>1097</sup> Id. at 383.

“Since mid-2003, the Saudi government has: set up a joint task force with the United States to investigate terrorist financing in Saudi Arabia; shuttered charitable organizations suspected of terrorist ties; passed anti-money laundering legislation; banned cash collections at mosques; centralized control over some charities; closed unlicensed money exchanges; and scrutinized clerics involved in charitable collections.”<sup>1098</sup>

Saudi Arabia also reported seizing illicit cash from terrorist organizations, shutting suspect bank accounts, designating several individuals as terrorist financiers, and killing two of them.<sup>1099</sup> In addition, Saudi Arabia established a Permanent Committee on Combating the Financing of Terrorism and a Financial Investigation Unit which began operations in September 2005.<sup>1100</sup>

Despite those advances, U.S. Government testimony and reports indicate that Saudi Arabia continued to be a focus of concern with respect to terrorist financing. In 2005, for example, U.S. Treasury Under Secretary for Terrorism and Financial Intelligence Stuart Levey testified before Congress: “[W]ealthy donors in Saudi Arabia are still funding violent extremists around the world, from Europe to North Africa, from Iraq to Southeast Asia.”<sup>1101</sup> He also testified that Saudi individuals may be “a significant source” of financing for the Iraq insurgency.<sup>1102</sup>

In 2007, in its annual International Narcotics Control Strategy Report, the U.S. Department of State wrote: “Saudi donors and unregulated charities have been a major source of financing to extremist and terrorist groups over the past 25 years.”<sup>1103</sup> A 2007 report to Congress by the Congressional Research Service stated: “U.S. officials remain concerned that Saudis continue to fund Al Qaeda and other terrorist organizations.”<sup>1104</sup> That same year, Congress enacted legislation which found that “Saudi Arabia has an uneven record in the fight against terrorism, especially with respect to terrorist financing,”

<sup>1098</sup> “Saudi Arabia: Terrorist Financing Issues,” Congressional Research Service Report for Congress, RL32499 (9/14/2007), <http://www.fas.org/sgp/crs/terror/RL32499.pdf> (hereinafter “2007 CRS Report on Saudi Arabia Terrorist Financing Issues”), in the summary. See also 2007 International Narcotics Control Strategy Report, U.S. Department of State, at 355-357.

<sup>1099</sup> 2007 CRS Report on Saudi Arabia Terrorist Financing Issues, at 25.

<sup>1100</sup> Id. at 24.

<sup>1101</sup> Stuart Levey testimony before the House Financial Services Subcommittee on Oversight and Investigations and House International Relations Subcommittee on International Terrorism and Nonproliferation (5/4/2005).

<sup>1102</sup> Stuart Levey testimony before the Senate Committee on Banking, Housing, and Urban Affairs (7/13/2005) (“Wealthy Saudi financiers and charities have funded terrorist organizations and causes that support terrorism and the ideology that fuels the terrorists’ agenda. Even today, we believe that Saudi donors may still be a significant source of terrorist financing, including for the insurgency in Iraq.”).

<sup>1103</sup> 2007 International Narcotics Control Strategy Report, U.S. Department of State, at 355.

<sup>1104</sup> 2007 CRS Report on Saudi Arabia Terrorist Financing Issues, in the summary.

and required the U.S. Government to develop a long-term strategy for working with Saudi Arabia to combat terrorist financing.<sup>1105</sup> On the sixth anniversary of the 9/11 attack, Treasury Under Secretary Levey said in a televised interview on terrorist financing: “[I]f I could somehow snap my fingers and cut off the funding from one country, it would be Saudi Arabia.”<sup>1106</sup>

In 2008, the U.S. State Department issued the long-term strategy required by the 2007 law.<sup>1107</sup> The strategy identified goals and “performance targets” to track progress in strengthening collaboration with Saudi Arabia to clamp down on terrorist financing. In April 2008, when questioned during a Senate hearing, Treasury Under Secretary Levey testified that, while Saudi Arabia had taken strong action against terrorists operating within its borders and was cooperating with the United States on an operational level, it was not working as hard to prevent funds from flowing to terrorists outside of its borders: “Saudi Arabia today remains the location from which more money is going to terror groups and the Taliban – Sunni terror groups and the Taliban – than from any other place in the world.”<sup>1108</sup>

In 2009, a report prepared for Congress by the U.S. Government Accountability Office (GAO) reviewed both the State Department’s long-term strategy and Saudi anti-terrorism efforts since 2005. GAO concluded: “U.S. and Saudi officials report progress on countering terrorism and its financing within Saudi Arabia, but noted challenges, particularly in preventing alleged funding for terrorism and violent extremism outside of Saudi Arabia.”<sup>1109</sup> GAO wrote:

“U.S. officials remain concerned about the ability of Saudi individuals and multilateral charitable organizations, as well as other individuals visiting Saudi Arabia, to support terrorism and violent extremism outside of Saudi Arabia. U.S. officials also noted that limited Saudi enforcement capacity and terrorist financiers’ use of cash couriers pose challenges to Saudi efforts to prevent financial support to extremists.”<sup>1110</sup>

<sup>1105</sup> See Section 2043(c), Implementing Recommendations of the 9/11 Commission Act, P.L. 110-53 (8/3/2007).

<sup>1106</sup> “U.S.: Saudis Still Filling Al Qaeda’s Coffers,” Brian Ross, ABC News (9/11/2007).

<sup>1107</sup> “U.S. Strategy Toward Saudi Arabia, Report Pursuant to Section 2043(c) of the Implementing Recommendations of the 9/11 Commission Act,” U.S. Department of State (1/30/2008).

<sup>1108</sup> Stuart Levey testimony before Senate Committee on Finance, “Anti-Terrorism Financing: Progress Made and Challenges Ahead,” (4/1/2008).

<sup>1109</sup> “Combating Terrorism: U.S. Agencies Report Progress Countering Terrorism and Its Financing in Saudi Arabia, but Continued Focus on Counter Terrorism Financing Efforts Needed,” U.S. Government Accountability Office, GAO-09-883 (Sept. 2009), <http://www.gao.gov/new.items/d09883.pdf>, at 1.

<sup>1110</sup> *Id.* at 29.

GAO also noted that certain performance targets set by the State Department had been dropped in 2009, such as the establishment of a Saudi Commission on Charities to oversee actions taken by Saudi charities abroad as well as certain regulations of cash couriers.<sup>1111</sup> GAO recommended that the United States reinstate the dropped performance targets to prevent the flow of funds from Saudi Arabia “through mechanisms such as cash couriers, to terrorists and extremists outside Saudi Arabia.”<sup>1112</sup>

Recently, Saudi Arabia won praise for its role in foiling a terrorist plan to smuggle a bomb onto an airline flight to the United States.<sup>1113</sup> The State Department’s most recent annual International Narcotics Control Strategy Report contains no information about Saudi Arabia’s anti-money laundering or terrorist financing efforts.<sup>1114</sup>

### C. Alleged Al Rajhi Links to Terrorism

In the ten years after the 9/11 attack in 2001, U.S. Government reports, criminal and civil legal proceedings, and media reports have alleged links between Al Rajhi family members and the Al Rajhi Bank to terrorist financing. The alleged links include that some Al Rajhi family members were major donors to al Qaeda or Islamic charities suspected of funding terrorism, established their own nonprofit organizations in the United States that sent funds to terrorist organizations, or used Al Rajhi Bank itself to facilitate financial transactions for individuals or nonprofit organizations associated with terrorism.

Many of the suspicions regarding Al Rajhi Bank stem from 2002, when the name of its most senior official, Sulaiman bin Abdul Azis Al Rajhi, appeared on an internal al Qaeda list of financial benefactors, and when a network of Al Rajhi-related nonprofit and business ventures located in Virginia was subjected to search by U.S. law enforcement seeking to disrupt terrorist financing activities in the United States.

**Al Qaeda List of Financial Benefactors.** The al Qaeda list of financial benefactors came to light in March 2002, after a search of the Bosnian offices of the Benevolence International Foundation, a Saudi based nonprofit organization which was also designated a terrorist organization by the Treasury Department, led to seizure of a CD-ROM

<sup>1111</sup> Id. at 15, 33.

<sup>1112</sup> Id. at 3.

<sup>1113</sup> See, e.g., “International sting operation brought down underwear bomb plot,” Los Angeles Times, Brian Bennett and Ken Dilanian (5/8/2012), [http://latimesblogs.latimes.com/world\\_now/2012/05/underwear-bomb-plot.html](http://latimesblogs.latimes.com/world_now/2012/05/underwear-bomb-plot.html).

<sup>1114</sup> 2012 International Narcotics Control Strategy Report, Volume II Country Database, U.S. Department of State, at 287-289.

and computer hard drive with numerous al Qaeda documents.<sup>1115</sup> One computer file contained scanned images of several hundred documents chronicling the formation of al Qaeda.<sup>1116</sup> One of the scanned documents contained a handwritten list of 20 individuals identified as key financial contributors to al Qaeda.<sup>1117</sup> Osama bin Laden apparently referred to that group of individuals as the “Golden Chain.”<sup>1118</sup> In a report prepared for Congress, the Congressional Research Service explained:

“According to the Commission’s report, Saudi individuals and other financiers associated with the Golden Chain enabled bin Laden and Al Qaeda to replace lost financial assets and establish a base in Afghanistan following their abrupt departure from Sudan in 1996.”<sup>1119</sup>

One of the 20 handwritten names in the Golden Chain document identifying al Qaeda’s early key financial benefactors is Sulaiman bin Abdul Aziz Al Rajhi, one of Al Rajhi Bank’s key founders and most senior officials.<sup>1120</sup>

The Golden Chain document has been discussed in the 9/11 Commission’s report, in Federal court filings, and civil lawsuits.<sup>1121</sup> Media reports as early as 2004 noted that the al Qaeda list included the

<sup>1115</sup> See *United States v. Enaam Arnaout*, Case No. 02-CR-892 (USDC NDIL), “Government’s Evidentiary Proffer Supporting the Admissibility of Coconspirator Statements,” (1/6/2003), <http://fl1.findlaw.com/news.findlaw.com/wsj/docs/bif/usarnaout10603prof.pdf> (hereinafter “Arnaout Evidentiary Proffer”), at 29. See also 2007 CRS Report on Saudi Arabia Terrorist Financing Issues, at 3; “Terrorism, 2002-2005,” FBI report, at 12, [http://www.fbi.gov/stats-services/publications/terrorism-2002-2005/terror02\\_05.pdf](http://www.fbi.gov/stats-services/publications/terrorism-2002-2005/terror02_05.pdf) (“On August 18, 2003, Enaam Arnaout, the director of Benevolence International Foundation, was sentenced to 11 years in federal prison after pleading guilty on February 10, 2003, to terrorism-related racketeering conspiracy charges. Arnaout had been indicted on October 9, 2002, for conspiracy to fraudulently obtain charitable donations in order to provide financial assistance to al-Qa’ida and other organizations engaged in violence and terrorism.”).

<sup>1116</sup> Arnaout Evidentiary Proffer, at 29.

<sup>1117</sup> Id. at 30.

<sup>1118</sup> Id. at 30. See also 2007 CRS Report on Saudi Arabia Terrorist Financing Issues,” at footnote 6. But see “Tangled Paths: A Sprawling Probe Of Terror Funding Centers in Virginia,” *Wall Street Journal*, Glenn Simpson (6/21/2004) (“Soon thereafter, a senior al Qaeda leader held by the Justice Department in New York confirmed the document’s authenticity in an interview with the FBI, referring to it as the Golden Chain, U.S. government court filings say.”).

<sup>1119</sup> 2007 CRS Report on Saudi Arabia Terrorist Financing Issues,” at 3.

<sup>1120</sup> A copy of the Golden Chain document was provided as Exhibit 5 to the Arnaout Evidentiary Proffer. Copies have also appeared on the Internet with English translations. See, e.g., “The Golden Chain,” Wikipedia, [http://en.wikipedia.org/wiki/The\\_Golden\\_Chain](http://en.wikipedia.org/wiki/The_Golden_Chain).

<sup>1121</sup> See *The 9/11 Commission Report: Final Report of the National Commission on Terrorist Attacks upon the United States*, (7/22/2004), at 55. See also, e.g., Arnaout Evidentiary Proffer at 29-30; *The Underwriting Members of Lloyd’s Syndicate 3500 v. Saudi Arabia*, Case 3:11-cv-00202-KRG (USDC WDP), Civil Complaint (9/8/11), [http://www.investigativeproject.org/documents/case\\_docs/1680.pdf](http://www.investigativeproject.org/documents/case_docs/1680.pdf), at 20.



Al Rajhi name.<sup>1122</sup> HSBC was clearly on notice about both the al Qaeda list and its inclusion of Sulaiman bin Abdul Aziz Al Rajhi.<sup>1123</sup>

**2002 Search Warrant.** Also in March 2002, as part of Operation Green Quest, a U.S. Treasury effort to disrupt terrorist financing activities in the United States,<sup>1124</sup> U.S. law enforcement agents conducted a search of 14 interlocking business and nonprofit entities in Virginia associated with the SAAR Foundation, an Al Rajhi-related entity, and the Al Rajhi family.<sup>1125</sup> Over 150 law enforcement officers participated in the search, generating widespread media coverage.<sup>1126</sup> A law enforcement affidavit supporting the search warrant detailed numerous connections between the targeted entities and Al Rajhi family members and related ventures.<sup>1127</sup> The affidavit stated that over 100 active and defunct nonprofit and business ventures in Virginia were part of what it described as the “Safa Group,”<sup>1128</sup> which the United States had reasonable cause to believe was “engaged in the money laundering tactic of ‘layering’ to hide from law enforcement authorities the trail of its support for terrorists.”<sup>1129</sup>

The SAAR Foundation is a Saudi-based nonprofit organization, founded by Sulaiman bin Abdul Aziz Al Rajhi in the 1970s, named after him, and used by him to support a variety of nonprofit endeavors, academic efforts, and businesses around the world. In 1983, the SAAR Foundation formed a Virginia corporation, SAAR Foundation, Inc., and operated it in the United States as a tax-exempt nonprofit organization under Section 501(c)(3) of the U.S. tax code.<sup>1130</sup> In 1996, another nonprofit organization was incorporated in Virginia called Safa Trust Inc.<sup>1131</sup> These and other nonprofit and business ventures associated with

<sup>1122</sup> See, e.g., “Tangled Paths: A Sprawling Probe Of Terror Funding Centers in Virginia,” Wall Street Journal, Glenn Simpson (6/21/2004).

<sup>1123</sup> See, e.g., 7/26/2007 email from OCC Joseph Boss to HBUS Alan Ketley, “Saudi’s,” HSBC OCC 2830874-879

(transmitting 2007 Wall Street Journal article to HBUS and requesting its response);

2/3/2010 email from HBUS Jon K. Jones to HBUS Ali S. Kazmy, “Islami Bank Bangladesh Ltd. – Poss SCC,” OCC-PSI-00453499 (“Al-Rajhi Bank got [its] start as a money chaining network and (Chairman Suleiman al-Rajhi appeared on the ‘Golden Chain’ of wealthy investors who supported Osama bin Laden.)”).

<sup>1124</sup> See “Operation Green Quest Overview,” U.S. Customs and Border Protection press release (2/26/2002), [http://www.cbp.gov/xp/cgov/newsroom/news\\_releases/archives/legacy/2002/22002/02262002.xml](http://www.cbp.gov/xp/cgov/newsroom/news_releases/archives/legacy/2002/22002/02262002.xml).

<sup>1125</sup> See “Affidavit in Support of Application for Search Warrant,” In Re Searches Involving 555 Grove Street, Herndon, Virginia and Related Locations, (USDC EDVA), submitted by David Kane, Senior Special Agent, U.S. Customs Service (hereinafter “Kane affidavit”), at ¶¶ 3-4 (describing investigation).

<sup>1126</sup> See, e.g., “Raids Seek Evidence of Money Laundering,” New York Times, Judith Miller (3/21/2002).

<sup>1127</sup> See Kane affidavit throughout, but in particular ¶¶ 178-180.

<sup>1128</sup> Kane affidavit at ¶ 1 (page 6).

<sup>1129</sup> Kane affidavit at ¶ 5.

<sup>1130</sup> Kane affidavit at ¶ 132.

<sup>1131</sup> Kane affidavit at ¶¶ 135-136.

the Al Rajhi family shared personnel and office space, primarily in Herndon, Virginia. In 2000, SAAR Foundation Inc. was dissolved,<sup>1132</sup> but the Safa Trust continued to operate.

An affidavit filed by the United States in support of the search warrant alleged that the Safa Group appeared to be involved with providing material support to terrorism. Among other matters, it alleged that members of the Safa Group had transferred "large amounts of funds ... directly to terrorist-front organizations since the early 1990's," including a front group for the Palestinian Islamic Jihad-Shikaki Faction, a designated terrorist organization.<sup>1133</sup> It also detailed a \$325,000 donation by the Safa Trust to a front group for Hamas, another designated terrorist organization.<sup>1134</sup> In addition, the affidavit expressed suspicion about a transfer of over \$26 million from members of the Safa Group to two offshore entities in the Isle of Man.<sup>1135</sup> The affidavit further alleged that "one source of funds flowing through the Safa Group [was] from the wealthy Al-Rajhi family in Saudi Arabia."<sup>1136</sup>

The search produced about 200 boxes of information which was then analyzed and used in other investigations and prosecutions, although neither the SAAR Foundation or Safa Trust has been charged with any wrongdoing.<sup>1137</sup> In 2003, Abdurahman Alamoudi, who had worked for SAAR Foundation Inc. from 1985 to 1990, as executive assistant to its president,<sup>1138</sup> pled guilty to plotting with Libya to assassinate the Saudi crown prince and was sentenced to 23 years in jail.<sup>1139</sup> He had also openly supported Hamas and Hezbollah, two terrorist organizations designated by the United States.<sup>1140</sup> According to an affidavit supporting the criminal complaint against him, Mr. Alamoudi admitted receiving \$340,000 in sequentially numbered \$100 bills from Libya while in London,<sup>1141</sup> and planned "to deposit the money in banks located in Saudi Arabia, from where he would feed it back in smaller sums into accounts in the United States."<sup>1142</sup> According to the affidavit, he also admitted involvement in similar cash transactions involving sums in the range of \$10,000 to \$20,000.<sup>1143</sup>

<sup>1132</sup> Kane affidavit at ¶ 132. See also "Raids Seek Evidence of Money Laundering," *New York Times*, Judith Miller (3/21/2002) (stating that, "although officially dissolved," the SAAR Foundation had recently occupied the Virginia offices subject to search).

<sup>1133</sup> Kane affidavit at ¶ 3.

<sup>1134</sup> Kane affidavit at ¶¶ 10(g), 161. Executive Order 12947 (1995).

<sup>1135</sup> Kane affidavit at ¶¶ 103-104.

<sup>1136</sup> Kane affidavit at ¶ 111 (emphasis in original omitted).

<sup>1137</sup> See *In re Grand Jury Subpoena (T-112)*, 597 F.3d 189 (4th Cir. 2/24/2010), at 191-192.

<sup>1138</sup> See *United States v. Alamoudi*, (USDC EDVA)(9/30/2003), "Affidavit in Support of Criminal Complaint," submitted by Brett Gentrup, Special Agent with U.S. Immigration and Customs Enforcement, (hereinafter "Gentrup affidavit"), ¶ 29.

<sup>1139</sup> See "Abdurahman Alamoudi Sentenced to Jail in Terrorism Financing Case," press release prepared by U.S. Department of Justice (10/15/2004).

<sup>1140</sup> See Gentrup affidavit at ¶ 35.

<sup>1141</sup> Gentrup affidavit at ¶¶ 39, 43.

<sup>1142</sup> Gentrup affidavit at ¶ 44.

<sup>1143</sup> Gentrup affidavit at ¶ 45.

The documents seized in the 2002 search were returned after about 18 months, but in 2006, were sought again through subpoenas issued by a Federal grand jury in Virginia.<sup>1144</sup> The Al-Rajhi related business and nonprofit ventures initially refused to re-supply the documents, then turned them over after a court imposed civil contempt fines totaling \$57,000.<sup>1145</sup> The Al Rajhi group then engaged in a four-year, unsuccessful court battle to nullify the fines.<sup>1146</sup> In addition, in 2004, Al Rajhi Bank filed a defamation lawsuit against the Wall Street Journal for a 2002 article describing how Saudi Arabia was monitoring certain accounts due to terrorism concerns.<sup>1147</sup> In 2004, the lawsuit settled; the Wall Street Journal did not pay any damages. It also published a letter from the bank's chief executive,<sup>1148</sup> and its own statement that the newspaper "did not intend to imply an allegation that [Al Rajhi Bank] supported terrorist activity, or had engaged in the financing of terrorism."<sup>1149</sup>

**2003 CIA Report.** While the widely publicized 2002 search fueled suspicions about Al Rajhi Bank's association with terrorist financing, a 2003 CIA report, discussed in a news article in 2007, provided another basis for concerns about the bank.

In 2003, the U.S. Central Intelligence Agency (CIA) issued a classified report entitled, "Al Rajhi Bank: Conduit for Extremist Finance."<sup>1150</sup> According to Wall Street Journal reporter, Glenn Simpson, this CIA report concluded: "Senior Al Rajhi family members have long supported Islamic extremists and probably know that terrorists use their bank."<sup>1151</sup> A later civil lawsuit, filed in 2011, provided a longer quotation from the same CIA report as follows:

"Islamic extremists have used Al-Rajhi Banking & Investment Corporation (ARABIC) since at least the mid-1990s as a conduit for terrorist transactions, probably because they find the bank's vast network and adherence to Islamic principles both convenient and ideologically sound. Senior al-Rajhi family members have long supported Islamic extremists and probably know that terrorists use their bank. Reporting indicates that senior al-Rajhi

<sup>1144</sup> See In re Grand Jury Subpoena (T-112), 597 F.3d 189 (4th Cir. 2/24/2010).

<sup>1145</sup> *Id.*

<sup>1146</sup> *Id.* See also "A Court Sheds New Light on Terror Probe," The New York Sun, Joseph Goldstein (3/24/2008).

<sup>1147</sup> The article was "Saudis Monitor Key Bank Accounts For Terror Funding at U.S. Request," Wall Street Journal, James Dorsey (2/6/2002), <http://online.wsj.com/article/SB109813587680048521.html>.

<sup>1148</sup> "Al Rajhi Bank's Statement on Journal's Article," Wall Street Journal, Abdullah Sulaiman Al Rajhi (10/19/2004), <http://online.wsj.com/article/SB109813521879148492.html>.

<sup>1149</sup> HSBC Financial Intelligence Group Report of Findings on Al Rajhi Bank, HSBC OCC 7519413 (12/13/2004).

<sup>1150</sup> "US Tracks Saudi Bank Favored by Extremists," Wall Street Journal, Glenn Simpson (7/26/2007), <http://online.wsj.com/article/SB118530038250476405.html>.

<sup>1151</sup> *Id.*

family members control the bank's most important decisions and that ARABIC's princip[al] managers answer directly to Suleiman. The al-Rajhis know they are under scrutiny and have moved to conceal their activities from financial regulatory authorities."<sup>1152</sup>

According to the same Wall Street Journal article by Glenn Simpson, the 2003 CIA report alleged that, in 2000, Al Rajhi Bank couriers "delivered money to the Indonesian insurgent group Kompak to fund weapons purchases and bomb-making activities."<sup>1153</sup> The report also allegedly claimed that in 2002, one year after the 9/11 attacks, the bank's managing director ordered the Al Rajhi Bank's board "to explore financial instruments that would allow the bank's charitable contributions to avoid official Saudi scrutiny."<sup>1154</sup> The 2003 CIA report allegedly stated further that extremists "ordered operatives in Afghanistan, Indonesia, Pakistan, Saudi Arabia, Turkey, and Yemen" to use Al Rajhi Bank.<sup>1155</sup>

**2005 Al Haramain Prosecution.** A third source of suspicion regarding Al Rajhi Bank's possible links to terrorism arose from a 2005 Federal indictment of al-Haramain Islamic Foundation Inc. and two of its senior officials. Al-Haramain Islamic Foundation is a Saudi-based nonprofit organization that, in 2005, operated in more than 50 countries around the world.<sup>1156</sup> Beginning in 2002, the United States designated multiple branches of the Foundation as terrorist organizations.<sup>1157</sup> After freezing the assets of two such branches for "diverting charitable funds to terrorism," a U.S. Treasury Department press release stated: "The branch offices of al Haramain in Somalia and Bosnia are clearly linked to terrorist financing."<sup>1158</sup> In 2004, a Treasury Department statement called al-Haramain Foundation "one of the principal Islamic NGOs [Non-Governmental Organizations] providing support for the Al Qaida network and promoting militant Islamic doctrine worldwide."<sup>1159</sup> That same year, the United States added the U.S. branch of the organization

<sup>1152</sup> The Underwriting Members of Lloyd's Syndicate 3500 v. Saudi Arabia, Case 3:11-cv-00202-KRG (USDC WDPA), Civil Complaint (9/8/2011), [http://www.investigativeproject.org/documents/case\\_docs/1680.pdf](http://www.investigativeproject.org/documents/case_docs/1680.pdf) (hereinafter "Lloyd's lawsuit"), at ¶ 370.

<sup>1153</sup> "US Tracks Saudi Bank Favored by Extremists," Wall Street Journal, Glenn Simpson (7/6/2007), <http://online.wsj.com/article/SB118530038250476405.html>.

<sup>1154</sup> *Id.*

<sup>1155</sup> *Id.*

<sup>1156</sup> United States v. al-Haramain Islamic Foundation Inc., Case No. 6:05-CR-60008-HO (USDC Oregon) Indictment (2/17/2005), at ¶ B.

<sup>1157</sup> See "Blocking Property and Prohibiting Transactions With Persons Who Commit, Threaten To Commit, or Support Terrorism," 66 FR 49079 (9/23/2001).

<sup>1158</sup> 3/11/2002 "Designations of Somalia and Bosnia-Herzegovina Branches of Al-Haramain Islamic Foundation," U.S. Treasury Department, <http://www.fas.org/irp/news/2002/03/dot031102fact.html>.

<sup>1159</sup> "Treasury Announces Joint Action with Saudi Arabia Against Four Branches of al-Haramain In The Fight Against Terrorist Financing," U.S. Treasury Department press release No. JS-1108 (1/22/2004), <http://www.treasury.gov/press/releases/js1108.htm>.

to the SDN list for acting as an “underwrit[er] of terror.”<sup>1160</sup> The Saudi government issued a similar 2004 designation and ordered the al-Haramain Islamic Foundation to be dissolved.<sup>1161</sup> In 2008, however, Treasury noted that, despite the Saudi government’s action, the organization’s leadership appeared to have reconstituted itself under a new name and continued to operate.<sup>1162</sup>

In the United States, representatives of the al-Haramain Islamic Foundation formed, in 1999, an Oregon corporation named al-Haramain Islamic Foundation, Inc. which set up offices in Ashland, Oregon.<sup>1163</sup> The corporation was operated as a nonprofit organization under Section 501(c)(3) of the U.S. tax code.<sup>1164</sup> In 2004, the Office of Foreign Assets Control (OFAC) at the Treasury Department deemed al-Haramain Islamic Foundation Inc. in Oregon a “Specially Designated Global Terrorist Entity.”<sup>1165</sup> In 2005, the United States indicted the Foundation and two of its senior officials, Pirouz Sedaghaty and Soliman Al-Buthe, who was later designated by the United States as a terrorist financier.<sup>1166</sup> Since both men were out of the country when the indictment was filed, the case was dormant for two years.<sup>1167</sup> In 2007, Mr. Sedaghaty returned to the United States and was arrested at an airport.<sup>1168</sup> In 2010, he stood trial, was convicted of two felonies, and sentenced to nearly three years in prison.<sup>1169</sup> In the incident that led to his conviction, he and Mr. Al-Buthe used funds from an Egyptian donor to purchase \$130,000 in U.S. travelers cheques from a bank in Oregon; Mr. Al-Buthe then traveled to Saudi Arabia and, in 2000, cashed the travelers cheques at Al Rajhi

<sup>1160</sup> See Executive Order No. 13,224 (2004); “U.S.-Based Branch of Al Haramain Foundation Linked to Terror,” U.S. Treasury Department press release (11/9/2004).

<sup>1161</sup> See, e.g., 2007 CRS Report on Saudi Arabia Terrorist Financing Issues, at 19.

<sup>1162</sup> See “Combating Terrorism: U.S. Agencies Report Progress Countering Terrorism and Its Financing in Saudi Arabia, but Continued Focus on Counter Terrorism Financing Efforts Needed,” U.S. Government Accountability Office, GAO-09-883 (Sept. 2009), <http://www.gao.gov/new.items/d09883.pdf>, at 35.

<sup>1163</sup> See United States v. al-Haramain Islamic Foundation Inc., Case No. 6:05-cr-60008-HO (USDC Oregon) Indictment (2/17/2005), at ¶ B.

<sup>1164</sup> *Id.*

<sup>1165</sup> See Executive Order No. 13224 (2004); “U.S.-Based Branch of Al Haramain Foundation Linked to Terror,” U.S. Treasury Department press release (11/9/2004); Al Haramain Islamic Foundation Inc. v. U.S. Dep’t of Treasury, 660 F.3d 1019, 1023 (9th Cir. 2011).

<sup>1166</sup> See United States v. al-Haramain Islamic Foundation Inc., Case No. 6:05-CR-60008-HO (USDC Oregon) Indictment (2/17/2005). The case was featured in the U.S. State Department’s annual report on money laundering issues. See 2005 International Narcotics Control Strategy Report, Volume II, “Money Laundering and Financial Crimes,” U.S. State Department, at 16. See also “U.S.-Based Branch of Al Haramain Foundation Linked to Terror,” U.S. Treasury Department press release No. JS-1895 (9/9/2004); “Tax Case Ends Against Charity,” Les Zaitz, The Oregonian (8/5/2005).

<sup>1167</sup> Because neither individual was in the United States, the prosecution later dropped the Foundation from the case, to prevent the case from proceeding in a piecemeal fashion. See Al Rajhi Banking & Investment Corp. v. Holder, Case No. 1:10-MC-00055-ESH, Memorandum of Points and Authorities In Support of Petitioner’s Motion to Quash USA Patriot Act Subpoena (1/19/2010), at 5.

<sup>1168</sup> *Id.*

<sup>1169</sup> “Former U.S. Head of Al-Haramain Islamic Foundation Sentenced to 33 Months in Federal Prison,” U.S. Attorney’s Office for the District of Oregon press release (9/27/11), at 1.

Bank; the money was then smuggled to violent extremists in Chechnya.<sup>1170</sup>

Al Rajhi Bank's role in the events that formed the basis for the prosecution attracted media attention in 2005, when the indictment was filed; in 2007, when Mr. Sedaghaty was arrested; and in 2010, when the trial took place. Over the years, it became public that Mr. Al-Buthe, a designated terrorist financier, had been a client of Al Rajhi Bank in Saudi Arabia in 2000,<sup>1171</sup> as had the al-Haramain Islamic Foundation, later designated a terrorist organization.<sup>1172</sup> In 2007, a Wall Street Journal article reported that Al Rajhi Bank had maintained at least 24 accounts for the al-Haramain Islamic Foundation and handled unusual transactions for it.<sup>1173</sup> In January 2010, after the United States served an administrative subpoena on Al Rajhi Bank to obtain authenticated bank documents for use in the al-Haramain Foundation criminal trial, the bank refused to produce them and filed a motion in court to quash the subpoena,<sup>1174</sup> leading to media reports that it was refusing to cooperate with a terrorist financing prosecution.<sup>1175</sup>

**Links to Suspect Banks.** In addition to the Golden Chain document, the U.S. search of Al-Rajhi related businesses and nonprofits in the United States, and the al Haramain Foundation prosecution, still another source of concern about Al Rajhi Bank involves its alleged links to other banks suspected of financing terrorism.

In 2011, a civil lawsuit filed by an insurance syndicate against Saudi Arabia and others seeking to recover insurance payments made after the 9/11 terrorist attack discussed two of those suspect banks, Bank

<sup>1170</sup> *Id.*

<sup>1171</sup> See, e.g., Al Rajhi Banking & Investment Corp. v. Holder, Case No. 1:10-MC-00055-ESH, Memorandum of Points and Authorities In Support of Petitioner's Motion to Quash USA Patriot Act Subpoena (filed 1-19-10), at 6.

<sup>1172</sup> See, e.g., "U.S. Tracks Saudi Bank Favored by Extremists," Wall Street Journal, Glenn Simpson (7/26/2007), <http://online.wsj.com/article/SB118530038250476405.html>. See also 7/26/2007 email from OCC Joseph Boss to HBUS Alan Ketley, "Saudi's," HSBC OCC 3391185 (transmitting the article to HBUS); email from HBUS Ketley to HBUS colleagues, Saudi's," HSBC OCC 3391262 (sharing the article within HBUS).

<sup>1173</sup> "US Tracks Saudi Bank Favored by Extremists," Wall Street Journal, Glenn Simpson (7/26/2007), <http://online.wsj.com/article/SB118530038250476405.html>.

<sup>1174</sup> See Al Rajhi Banking & Investment Corp. v. Holder, Case No. 1:10-MC-00055-ESH, Memorandum of Points and Authorities In Support of Petitioner's Motion to Quash USA Patriot Act Subpoena (1/19/2010). This case was later closed as "moot." See Order Dismissing Action As Moot (3/2/2010) ("It is hereby ordered that this action is dismissed as moot in light of the ruling issued on February 26, 2010, by Judge Michael R. Hogan of the U.S. District Court for the District of Oregon in *United States v. Sedaghaty*...granting the government's motion to compel petitioner Al-Rajhi Banking and Investment Corp.'s compliance with an administrative subpoena.") (emphasis in original omitted).

<sup>1175</sup> See, e.g., "Saudi Bank Refuses to Cooperate in U.S. Investigation into Terrorist Financiers," For The Record - The IPT Blog (1/26/2010), <http://www.investigativeproject.org/1753/saudi-bank-refuses-to-cooperate-in-us>.

al Taqwa and Akida Bank Private Ltd.<sup>1176</sup> Both banks have been deemed by the United States as Specially Designated Global Terrorist Entities.<sup>1177</sup> Regarding Bank al Taqwa, the lawsuit noted that two individuals who were former executives at Bank al Taqwa, Ibrahim Hassabella and Samir Salah, were also associated with the SAAR Foundation.<sup>1178</sup> Mr. Hassabella was a former secretary of al Taqwa Bank and a shareholder of SAAR Foundation Inc. Mr. Saleh was a former director and treasurer of the Bahamas branch of al Taqwa Bank, and president of the Piedmont Trading Corporation which was part of the SAAR network. The U.S. Treasury Department has stated: “The Al Taqwa group has long acted as financial advisers to al Qaeda, with offices in Switzerland, Lichenstein, Italy and the Caribbean.”<sup>1179</sup> Regarding Akida Bank, the lawsuit complaint alleged that Sulaiman bin Abdul Aziz Al Rajhi was “on the board of directors of Akida Bank in the Bahamas” and that “Akida Bank was run by Youssef Nada, a noted terrorist financier.”<sup>1180</sup>

As explained below, Al Rajhi Bank was also associated with Islami Bank Bangladesh Ltd., which was located in a country at high risk for money laundering, provided an account to a Bangladeshi accused of involvement with a terrorist bombing, and had been fined three times for violating AML requirements in connection with providing bank services to “militants.”<sup>1181</sup> HSBC’s own research indicated that the Al Rajhi group held about one-third of the bank’s shares. In addition, Al Rajhi Bank provided a correspondent account to Social Islami Bank, a Bangladesh-based bank whose largest single shareholder for many years was the International Islamic Relief Organization, which was designated by the United States in 2006, as a terrorist organization.<sup>1182</sup> A second shareholder was the precursor to the Benevolence Islamic Foundation, also later designated by the United States as a terrorist organization.

<sup>1176</sup> See Lloyd’s lawsuit at ¶¶ 459-460. This lawsuit was withdrawn 11 days after being filed, with no prejudice against its re-filing in the future. See Lloyd’s lawsuit, Notice of Voluntary Dismissal, Docket document 5, 9/19/2011.

<sup>1177</sup> See “The United States Designates Twenty-Five New Financiers of Terror,” U.S. Treasury Department press release (8/29/2002), <http://www.treasury.gov/press-center/press-releases/Pages/po3380.aspx>. See also E.O. 13224, “Blocking Property and Prohibiting Transactions With Persons Who Commit, Threaten To Commit, or Support Terrorism,” 66 FR 49079 (9/23/2001); Kane affidavit at ¶ 112.

<sup>1178</sup> Lloyd’s lawsuit at ¶ 459.

<sup>1179</sup> Statement by Treasury Secretary Paul O’Neill (11/7/2001).

<sup>1180</sup> Lloyd’s lawsuit at ¶ 459. Youssef Nada was designated as a terrorist financier by the United States in November 2001. See “Recent OFAC Actions,” U.S. Department of the Treasury, (11/7/2001), <http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20011107.aspx>.

<sup>1181</sup> See Subsection I(1), below.

<sup>1182</sup> See Subsection I(2), below. See also “Islamic Charity Charged with Terrorist Financing,” U.S. Justice Department, (1/16/2008), <http://www.justice.gov/usao/mow/news2008/iara.ind2.htm>.

**Suspect Bank Clients.** A final source of concern about Al Rajhi Bank involves accounts it provided to specific clients linked to terrorism. The accounts provided to the al-Haramain Islamic Foundation and Soliman Al-Buthe, both designated by the United States as linked to terrorism, have already been discussed. Another example is the International Islamic Relief Organization (IIRO) which, as mentioned earlier, is a Saudi-based nonprofit organization which was added to the SDN list by the United States for “facilitating fundraising for Al Qaida and affiliated terrorist groups”.<sup>1183</sup> In 2003, HSBC’s internal Financial Intelligence Group (FIG) raised questions about the IIRO; in 2006 a FIG report noted that the IIRO had been linked to Al Qaeda and other terrorist groups, plots to assassinate President Bill Clinton and the Pope, attacks on the Brooklyn Bridge and Lincoln Tunnel, and the 1993 attack on the World Trade Center.<sup>1184</sup> According to a CRS report, press reports indicated that, until at least December 2004, the IIRO had arranged for donors to send donations directly to accounts it held at Al Rajhi Bank, advertizing the accounts in various publications.<sup>1185</sup> In addition, the Lloyd’s lawsuit alleged that Al Rajhi Bank made or arranged for large donations to the IIRO.<sup>1186</sup> Sulaiman bin Abdul Aziz Al Rajhi, the most senior official at Al Rajhi Bank, is also alleged to have been an officer of IIRO.<sup>1187</sup>

<sup>1183</sup> See 8/3/2006 press release, “Treasury Designates Director, Branches of Charity Bankrolling Al Qaida Network,” U.S. Treasury Department, reprinted in 8/3/2006 email from HBUS Sharyn Malone to HBUS Stephanie Napier and others, “Social Investment Bank, Bangladesh,” HSBC OCC 3259936. See also 8/3/2006 “Treasury Takes Additional Measures to Combat Iranian WMD Proliferation Iranian Nuclear & Missile Firms Targeted,” Treasury press release, <http://www.treasury.gov/press-center/press-releases/Pages/hp45.aspx>.

<sup>1184</sup> 8/4/2006 FIG Report on Findings (Update) for Social Investment Bank Limited, OCC-PSI-00823818 at 12.; 11/2003 FIG Report on Findings for Social Investment Bank, Ltd., OCC-PSI-00823818, at 18. See also *In Re September 11<sup>th</sup> Litigation*, C.A. 04-7280 (S.D.N.Y. 2010), at ¶ 371.

<sup>1185</sup> See, e.g., 2007 CRS Report on Saudi Arabia Terrorist Financing Issues, at 9, footnote 35 (citing *International Islamic News Agency* (Jeddah), “IIRO Distributes Aid to Falluja War Victims,” (12/21/2004), <http://www.saudiembassy.net/2003News/News/RelDetail.asp?cIndex=737>). See also Lloyd’s lawsuit at ¶¶ 445, 447 (alleging IIRO advertised sending donations to its accounts at Al Rajhi Bank, Accounts No. 77700-77709, in its own publications, and Al Rajhi Bank advertised sending donations to IIRO accounts at the bank in the Al Igatha Journal in several countries).

<sup>1186</sup> Lloyd’s lawsuit at ¶ 446-448 (alleging “Al Rajhi Bank collected charitable donations on behalf of Sanabel al Kheer (‘Seeds of Charity’), the financial/investment arm of the IIRO, depositing the donations into Sanabel’s Al Rajhi Bank account no. 77707. ... Under the guise of IIRO funds labeled and designated for purposes such as ‘war and disaster’ (Account number for Immigrants, Refugees, and Victims of Disasters: 77702) or ‘sponsor a child’ (IIRO Account Number of Deprived Children: 77704), charitable organizations such as the IIRO use banks like Al Rajhi Bank to gather donations that fund terrorism and terrorist activities. ... Al Rajhi Bank also handled IIRO ‘charitable’ contributions intended to benefit suicide bombers by directing Al Igatha Journal advertisements ... in Somalia, Sri Lanka, India, and the Philippines under IIRO Account number 77709 .... On February 17, 1994, Al Rajhi Bank made a \$533,333 donation to the Saudi High Commission (‘SHC’) in response to a call for donations for Bosnia and Somalia. In August 1995, Al Rajhi Bank contributed \$400,000 to the SHC which was collecting donations for Bosnia during a 12-hour telethon. The donation was identified by the Arabic newspaper Asharq al Awsat.”).

<sup>1187</sup> See, e.g., Lloyd’s lawsuit at ¶ 9.



Al Rajhi Bank gained notoriety as well for providing banking services to several of the hijackers in the 9/11 terrorist attack, including Abdulaziz al Omari who was aboard American Airlines Flight 11. A civil lawsuit described the bank's involvement with him as follows:

"[M]oney was funneled to the Hamburg, Germany al Qaeda cell through the Al Rajhi Bank to businessmen Mahmoud Darkazanli and Abdul Fattah Zammar, who in turn provided the al Qaeda cell of September 11<sup>th</sup> hijackers with financial and logistical support. Through Al Rajhi Bank, September 11<sup>th</sup> hijacker Abdulaziz al Omari received funds into his Al Rajhi Bank Account Number .... Al Omari frequently utilized a credit card drawn on Al Rajhi Bank in the planning of the attacks. On September 7, 2001, four days before the 9/11 attacks, al Omari received a wire transfer from Al Rajhi Bank, Buraidah Branch, Jeddah, Saudi Arabia ...."<sup>1188</sup>

Taken together, the information – the Al Qaeda Golden Chain document, the 2002 search of Al Rajhi-related entities in Virginia, the 2003 CIA report, the 2005 al Haramain Foundation indictment and trial, the 2007 media reports, the 2010 refusal to provide bank documents in a terrorist-financing trial, and the multiple links to suspect banks and accountholders – present an unusual array of troubling allegations about a particular financial institution. When asked about these matters, Al Rajhi Bank has repeatedly condemned terrorism and denied any role in financing extremists.<sup>1189</sup> In addition, despite all the allegations, neither the bank nor its owners have ever been charged in any country with financing terrorism or providing material support to terrorists.

HSBC was fully aware of the suspicions that Al Rajhi Bank and its owners were associated with terrorist financing, describing many of the alleged links in the Al Rajhi Bank client profile.<sup>1190</sup> On one occasion in 2008, the head of HSBC Global Banknotes Department told a colleague: "In case you don't know, no other banknotes counterparty has received so much attention in the last 8 years than Alrajhi."<sup>1191</sup> Despite, in the words of the KYC client profile, a "multitude" of allegations, HSBC chose to provide Al Rajhi bank with banking services on a global basis.

<sup>1188</sup> Lloyd's lawsuit at ¶ 449.

<sup>1189</sup> See, e.g., "Al Rajhi Bank's Statement on Journal's Article," *Wall Street Journal*, Abdullah Sulaiman Al Rajhi (10/19/2004), <http://online.wsj.com/article/SB109813521879148492.html>; "Al Rajhi Bank responds to Wall Street Journal report," distributed by PR Newswire, (10/24/2003), <http://www.thefreelibrary.com/Al+Rajhi+Bank+responds+to+Wall+Street+Journal+report.-a0109218136>.

<sup>1190</sup> See, e.g., 2010 HBUS KYC Profile of Al Rajhi Bank, at 6, 11.

<sup>1191</sup> 5/2008 email from Christopher Lok to Gary C H Yeung, "KYC Approval needed for: AL RAJHI BANKING & INVESTMENT CORP," OCC-PSI-00155690.

#### D. HSBC Relationship with Al Rajhi Bank

In the United States, Al Rajhi Bank first became a client of Republic Bank of New York during the 1970s; after Republic Bank of New York was purchased by HSBC, Al Rajhi Bank became a client of HSBC Bank United States (HBUS).<sup>1192</sup> HSBC also had longstanding relationships with Al Rajhi Bank and other Al Rajhi-related businesses in other parts of the world, including the Middle East, Europe, and the Far East, which HSBC had developed separately from the relationship it assumed from Republic Bank of New York in the United States.<sup>1193</sup> HSBC provided Al Rajhi Bank with a wide range of banking services, including wire transfers, foreign exchange, trade financing, and asset management services.<sup>1194</sup> In addition, in 1998, HSBC Group established “HSBC Amanah,” a “global Islamic financial services division” designed to “serve the particular needs of Muslim communities” in compliance with Islamic law, and provided those banking services to Al Rajhi Bank and other Al Rajhi-related businesses.<sup>1195</sup>

In the United States, a key service was supplying Al Rajhi Bank with large amounts of physical U.S. dollars, through the HBUS U.S. Banknotes Department. The physical delivery of U.S. dollars to Al Rajhi Bank was carried out primarily through the London branch of HBUS, often referred to internally as “London Banknotes.” HBUS records indicate that the London Banknotes office had been supplying U.S. dollars to Al Rajhi Bank for “25+ years.”<sup>1196</sup> In addition to the London branch, HBUS headquarters in New York opened a banknotes account for Al Rajhi Bank in January 2001.<sup>1197</sup> The U.S. dollars were physically delivered to Al Rajhi Bank in Saudi Arabia.<sup>1198</sup>

In January 2005, a little more than three years after the 9/11 terrorist attack on the United States, HBUS decided to end its relationship with Al Rajhi Bank due to terrorist financing concerns, as explained further below.<sup>1199</sup> Nearly two years later, in December 2006, the relationship was reactivated and continued for another four years,

<sup>1192</sup> See 2010 HBUS KYC Profile of Al Rajhi Bank, at 4.

<sup>1193</sup> Id.

<sup>1194</sup> See, e.g., 2010 KYC Profile of Al Rajhi Bank at 8; 5/23/2005 document prepared by CIBM-Institutional Banking on Al Rajhi Banking and Investment Corporation, at HSBC OCC 0659988-997, at 8.

<sup>1195</sup> See HSBC website, “About HSBC Amanah,” <http://www.hsbeamamah.com/amanah/about-amanah>.

<sup>1196</sup> 2010 HBUS KYC Profile of Al Rajhi Bank, at 3, 5. The London Banknotes office supplied U.S. dollars to both Al Rajhi Bank and, until its account closed in 2005, Al Rajhi Trading Establishment. Another HBUS branch office in Hong Kong also did banknotes business with Al Rajhi Bank beginning in 2009. See HBUS “Know Your Customer Profile – Banknote Information,” for the Hong Kong office regarding Al Rajhi Bank (10/29/2010), HSBC-PSI-PROD-0102782-784, at 1.

<sup>1197</sup> 2010 HBUS KYC Profile of Al Rajhi Bank, at 2, 3.

<sup>1198</sup> Id. at 2.

<sup>1199</sup> Id.

until 2010, when it was ended once more due to a group-wide decision by HSBC to exit the U.S. banknotes business. HBUS closed its banknotes account with Al Rajhi Bank in October 2010.<sup>1200</sup>

From 2000 to 2010, HSBC assigned a series of Global Relationship Managers to the Al Rajhi Bank account. They include Shariq Siddiqi<sup>1201</sup> and Shamzani Bin Md Hussain.<sup>1202</sup> In 2005, the Relationship Manager for KYC approval purposes was Beth Fisher. From 2005 to 2010, the head of the HSBC Global Banknotes business was Christopher Lok, who was based in New York; the regional Banknotes head for the Americas was Gyanen Kumar, who was based in New York; and the regional Banknotes head in charge of the London Banknotes office was Stephen Allen.<sup>1203</sup>

HSBC classified Al Rajhi Bank as a “Special Category of Client” (SCC), its highest risk designation.<sup>1204</sup> This designation was due in part to the bank’s location in Saudi Arabia, which HSBC classified as a high risk country. In addition, HSBC noted that the bank was owned in part by a Politically Exposed Person (PEP), Abdullah Abdul Al Rajhi, who was a major shareholder, a member of the bank’s board of directors, and a member of the Northern Borders Provincial Council in Saudi Arabia.<sup>1205</sup> Al Rajhi Bank was one of only a handful of bank clients that HSBC had classified as SCC clients.<sup>1206</sup>

#### **E. Al Rajhi Trading Establishment**

In addition to Al Rajhi Bank, HSBC provided accounts to Al Rajhi Trading Establishment, a money exchange business based in Saudi Arabia and owned by Rajhi family members. This account closed in 2005, when the business, along with seven others, merged into a new bank, Al Bilad Bank in Saudi Arabia.

According to HSBC internal documents, Al Rajhi Trading Establishment opened two accounts in 1994, with Republic Bank of New York before its purchase by HSBC.<sup>1207</sup> One account processed payments, such as from travelers cheques or money orders, while the other handled foreign currency exchange. According to HSBC

<sup>1200</sup> Id. 1, 15.

<sup>1201</sup> 5/23/2005 document prepared by CIBM-Institutional Banking on Al Rajhi Banking and Investment Corporation, HSBC OCC 0659988-997, at 7.

<sup>1202</sup> 2010 HBUS KYC Profile of Al Rajhi Bank, at 4.

<sup>1203</sup> 11/2006 HBUS “Banknotes Trading A Global Reach Organizational Chart As of November 2006,” OCC-PSI-0000050, at 5.

<sup>1204</sup> 2010 HBUS KYC Profile of Al Rajhi Bank, at 1.

<sup>1205</sup> Id. at 1, 3.

<sup>1206</sup> Id. at 3.<sup>1207</sup> March 2002 email chain among HBUS personnel, “Al Rajhi Trading establishment,” OCC-PSI-00381727, at 3.

<sup>1207</sup> March 2002 email chain among HBUS personnel, “Al Rajhi Trading establishment,” OCC-PSI-00381727, at 3.

documents, Republic Bank of New York had a policy of not dealing with money exchange businesses, but had made an exception for Al Rajhi Trading Establishment due to a “long relationship with the bank, their knowledge of the stiff penalties (death) for drug trafficking and money laundering within the country and the general good reputation of exchange houses in Saudi Arabia.”<sup>1208</sup> After HSBC purchased Republic Bank of New York, the Al Rajhi Trading Establishment accounts were handled by the HSBC International Private Banking Department.<sup>1209</sup>

In 2002, after the 9/11 attack on the United States, the International Private Banking Department asked to transfer the two accounts to HSBC’s Institutional Banking Department in Delaware which had superior ability to monitor account activity.<sup>1210</sup> In connection with the transfer, HBUS banker Joseph Harpster wrote:

“The most recent concern arose when three wire transfers for small amounts (\$50k, \$3k and \$1.5k) were transferred through the account for names that closely resembled names, not exact matches, of the terrorists involved in the 9/11 World Trade Center attack. ... The profile of the main account reflects a doubling of wire transfer volume since 9/01, a large number of travelers checks but with relatively low value and some check/cash deposits. According to the account officer, traffic increased because they have chosen to send us more business due to their relationship with Saudi British Bank<sup>1211</sup> and the added strength of HBC versus Republic. ... Maintaining our business with this name is strongly supported by David Hodgkinson of [Saudi British Bank] and Andre Dixon, Deputy Chairman of [HSBC Bank Middle East]. Niall Booker and Alba Khoury [of HBUS] also support.”<sup>1212</sup>

Douglas Stolberg head of Commercial and Institutional Banking (CIB) at HBUS forwarded the email to Alexander Flockhart, then a senior executive in Retail and Commercial Banking at HBUS, noting: “As we discussed previously, Compliance has raised some concerns regarding the ongoing maintenance of operating/clearing accounts for Al Rajhi group.” He forwarded recommendations on how to handle the account: “Retain [International Private Banking] as the relationship manager domicile for continuity purposes, and as we understand there is interest in further developing private banking business with family

<sup>1208</sup> Id.

<sup>1209</sup> Id.

<sup>1210</sup> Id.

<sup>1211</sup> HSBC owned Saudi British Bank. See “Doing Business in Saudi Arabia,” an HSBC publication, [http://www.hsbc.com/1/content/assets/business\\_banking/1100511\\_hsbc\\_doing\\_business\\_in\\_saudi.pdf](http://www.hsbc.com/1/content/assets/business_banking/1100511_hsbc_doing_business_in_saudi.pdf).

<sup>1212</sup> March 2002 email chain among HBUS personnel, “Al Rajhi Trading establishment,” OCC-PSI-00381727, at 3.

members. ... Domicile the actual accounts with Delaware where HBUS's most robust account screening capabilities reside." His email also stated:

"[T]his has become a fairly high profile situation. Compliance's concerns relate to the possibility that Al Rajhi's account may have been used by terrorists. If true, this could potentially open HBUS up to public scrutiny and /or regulatory criticism. SABB [Saudi British Bank] are understandably keen to maintain the relationships. As this matter concerns primarily reputational and compliance risks, we felt it appropriate for SMC [Senior Management Committee] members to be briefed ... so that they may opine on the acceptability of the plan. Please advise how you would prefer us to proceed."<sup>1213</sup>

Mr. Harpster reported a week later that Mr. Flockhart had decided to transfer the accounts to HBUS in the Delaware office.

Three years later, in 2005, eight Saudi money exchangers, including Al Rajhi Trading Establishment, were merged into a new Al Bilad Bank in Saudi Arabia.<sup>1214</sup> The HSBC accounts for Al Rahji Trading Establishment closed in November 2005.<sup>1215</sup>

#### **F. 2005: Decision to Sever Ties with Al Rajhi Bank**

In 2005, despite its longstanding relationship with Al Rajhi Bank, HSBC Group Compliance decided that its U.S.-based businesses should sever ties with Al Rajhi Bank due to terrorist financing concerns.<sup>1216</sup> To carry out this decision, on January 28, 2005, Teresa Pesce, head of HBUS AML Compliance, sent an email to HBUS personnel entitled, "Al Rahji Trading/Al Rahji Banking":

"As some of you may know, the above named clients have been under evaluation by US and Group Compliance based, among other things, on relationships maintained with entities/countries on the OFAC list. Additionally, US law enforcement has placed these entities under scrutiny. After much consideration, Group Compliance has recommended that the US businesses sever ties with these clients based on the current regulatory environment and

<sup>1213</sup> Id. at 2-3.

<sup>1214</sup> See April 2005 HBUS Financial Intelligence Group (FIG) Report of Findings (Update) on Al Rajhi Trading Establishment, HSBC OCC 2725168-169. Another Al Rajhi-related business, the Al Rajhi Commercial Foreign Exchange, was also one of the eight businesses that merged into Al Bilad Bank. See 7/13/2005 HBUS Financial Intelligence Group (FIG) Report of Findings (Update) on Al Rajhi Commercial Foreign Exchange, HSBC OCC 2725167-168.

<sup>1215</sup> 4/12/12 HSBC legal counsel response to Subcommittee inquiry.

<sup>1216</sup> 2010 HBUS KYC Profile of Al Rajhi Bank, at 2 ("relationship exited and deactivated on 2 February 2005 due to TF issues").

the interest of US law enforcement. Accordingly, I will not approve customer profiles for or transactions with these entities. Please make appropriate arrangements. I am available to answer any questions you might have.”<sup>1217</sup>

At the time the email was issued, Al Rajhi Bank had not been indicted, designated as a terrorist financier, or sanctioned by any country, including the United States. HSBC Group Compliance based its decision on concerns that the bank had relationships “with entities/countries on the OFAC list,” the bank was of “interest” to U.S. law enforcement which had placed it “under scrutiny,” and severing the relationship was called for in light of the “current regulatory environment.”<sup>1218</sup>

The 2005 decision was made several years after the 9/11 terrorist attack, as U.S. law enforcement and bank regulators directed increasing scrutiny to terrorist financing issues. As discussed earlier, in 2004, the 9/11 Commission issued its report which included information on the role of Saudi Arabia in financing terrorism, described the “Golden Chain” of al Qaeda’s financial benefactors, and noted that one of the hijackers had an account at Al Rajhi Bank. Congress held hearings on that report. The media also disclosed in 2004, that Al Rajhi Bank’s most senior official was on the Golden Chain list.<sup>1219</sup> In addition, 2004 saw the United States designate as terrorist organizations several Saudi-based nonprofit organizations that were also clients of Al Rajhi Bank, including the International Islamic Relief Organization and the al Haramain Foundation, adding them to the OFAC list of entities with which U.S. persons were prohibited from doing business.<sup>1220</sup> U.S. prosecutors also intensified their investigation of al Haramain Foundation Inc., whose 2005 indictment would disclose that its senior officials had cashed \$130,000 in U.S. travelers checks at Al Rajhi Bank in Saudi Arabia and used the money to support violent extremists in Chechnya.<sup>1221</sup>

On the regulatory front, in July 2004, this Subcommittee held hearings on how U.S. banks and U.S. bank regulators had failed to fully

<sup>1217</sup> 1/28/2005 email from HBUS Teresa Pesce to numerous HSBC colleagues, “Al Rajhi Trading/Al Rajhi Banking,” HSBC OCC 1884218.

<sup>1218</sup> When asked about this decision, David Bagley, the head of HSBC Group Compliance, told the Subcommittee that there was no single incident that led to the decision. Subcommittee interview of David Bagley (5/10/2012).

<sup>1219</sup> See, e.g., “Tangled Paths: A Sprawling Probe Of Terror Funding Centers in Virginia,” Wall Street Journal, Glenn Simpson (6/21/2004).

<sup>1220</sup> “Blocking Property and Prohibiting Transactions With Persons Who Commit, Threaten To Commit, or Support Terrorism,” 66 FR 49079 (9/23/2001) (see Annex).

<sup>1221</sup> The U.S. Treasury Department was later quoted as saying Al Rajhi Bank maintained at least 24 accounts and handled unusual transactions for the al Haramain Foundation. “US Tracks Saudi Bank Favored by Extremists,” Wall Street Journal, Glenn Simpson (7/26/2007), <http://online.wsj.com/article/SB118530038250476405.html>.

implement the tougher AML requirements enacted into law as part of the USA Patriot Act of 2001,<sup>1222</sup> highlighting Riggs Bank as an example.<sup>1223</sup> Among other measures, the Patriot Act required U.S. financial institutions to establish AML programs, conduct special due diligence on correspondent accounts opened for foreign banks, and verify the identity of account holders.<sup>1224</sup> The law also deemed money laundering through foreign banks and the laundering of terrorism proceeds as criminal offenses in the United States.<sup>1225</sup> These new provisions had given rise to new bank regulations, new examination requirements, and a new emphasis on the importance of AML controls.

HBUS' primary U.S. regulator, the OCC, scheduled an AML examination of the HBUS banknotes business to take place in 2005.<sup>1226</sup> In December 2004, in anticipation of that examination, the HBUS Global Banknotes Department had completed a review of its Know Your Customer (KYC) client profiles.<sup>1227</sup> In October 2004, the HSBC Global Relationship Manager for Al Rajhi Bank, Shariq Siddiqi, visited the bank and reviewed its KYC/AML procedures in detail.<sup>1228</sup> Mr. Siddiqi praised the procedures and noted: "The management appeared fully cognizant of the reputational risks associated with terrorism financing, and confirmed Al Rajhi Bank's strong commitment to combat it."<sup>1229</sup>

Despite that endorsement of the bank's AML policies and procedures, HBUS AML Compliance did not approve the Al Rajhi Bank KYC profile, an action it took with respect to only a few clients out of more than 930 active client profiles reviewed.<sup>1230</sup> The failure to approve the client profile meant that bank personnel were unable to do business with the client. HBUS AML Compliance Officer Alan Ketley circulated

<sup>1222</sup> See Title III of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA Patriot Act) Act of 2001, P.L. 107-56 (10/26/2001).

<sup>1223</sup> "Money Laundering and Foreign Corruption: Enforcement and Effectiveness of the Patriot Act, Case Study Involving Riggs Bank," S.Hrg. 108-633 (July 15 2004).

<sup>1224</sup> See USA Patriot Act, §§ 312, 326, 352.

<sup>1225</sup> See USA Patriot Act, §§ 318, 376, 377.

<sup>1226</sup> See 3/8/2005 email from Daniel Jack, HBUS, to Denise Reilly and Alan Ketley in HBUS, "Re: KYC Deactivation Report for Banknotes in Feb-05," OCC-PSI-00169771 ("There has been a surge in KYC updates in the past few months due to clean-up/prep for OCC."); 6/20/2005 OCC Supervisory Letter on Global Banknote AML examination, OCC-PSI-00107505-510 (containing six Matters Requiring Attention by the bank related to AML deficiencies) [sealed exhibit].

<sup>1227</sup> See 1/4/2005 email from Daniel Jack, HBUS Legal Compliance, to HBUS KYC Account Managers, HBUS KYC Banknote Traders, and others, "KYC Status of Profiles for Banknotes by Office: December 2004," HSBC OCC 2405588-589. See also 3/7/2005 email from Daniel Jack to Alan Ketley and others, "Re: KYC Deactivation Report for Banknotes in Feb-05," OCC-PSI-00169771 (noting that Al Rajhi Bank was one of only two client profiles "deactivated for AML/KYC/Compliance Reasons").

<sup>1228</sup> 5/23/2005 document prepared by CIBM-Institutional Banking on Al Rajhi Banking and Investment Corporation, HSBC OCC 0659988-997, at 3.

<sup>1229</sup> Id. at HSBC OCC 0659991.

<sup>1230</sup> 1/4/2005 email from Daniel Jack, HBUS Legal Compliance, to HBUS KYC Account Managers, HBUS KYC Banknote Traders, and others, "KYC Status of Profiles for Banknotes by Office: December 2004," at HSBC OCC 2405588-589. See also 3/7/2005 email from Daniel Jack to Alan Ketley and others, "Re: KYC Deactivation Report for Banknotes in Feb-05," OCC-PSI-00169771 (noting that Al Rajhi Bank was one of only two client profiles "deactivated for AML/KYC/Compliance Reasons").

instructions on how to handle clients, including Al Rajhi Bank and Al Rajhi Trading Establishment, whose profiles had been “denied” by HBUS Compliance. He explained that such clients must be given “10 days notice of trading termination unless a dispensation is obtained from the AML Director and an updated profile is approved by the AML Director within that 10 day period. For current customers that 10 day clock will commence on December 7 (so December 17 will be the final day we will transact with them unless a dispensation is obtained.)”<sup>1231</sup>

On January 4, 2005, HBUS AML Compliance head Ms. Pesce sent an email to Daniel Jack, an HBUS AML Compliance Officer who often dealt with the London Banknotes office, instructing him to: “[p]lease communicate that Group Compliance will be recommending terminating the Al Rahji relationship.”<sup>1232</sup> Mr. Jack inquired as to when that recommendation would be made. She responded:

“I expect to see an email from Susan Wright today. She tells me that HBME [HSBC Bank Middle East] does not agree with Compliance and will not be terminating the relationship from the Middle East, but she/David B[agley] recommend that in light of US scrutiny, climate, and interest by law enforcement, we in the US sever the relationship from here.”<sup>1233</sup>

Susan Wright was then the Chief Money Laundering Control Officer for the entire HSBC Group. She reported to David Bagley, head of the HSBC Group’s overall Compliance Department. The documents do not explain why HSBC Middle East disagreed with the decision or why it was allowed to continue its relationship with Al Rajhi Bank, when HSBC’s Group Compliance had decided to sever the relationship between the bank and other HSBC affiliates due to terrorist financing concerns.

The decision to sever ties with Al Rajhi Bank was announced internally within HSBC on January 28, 2005. The decision clearly affected some HSBC affiliates, such as HBUS and its London Banknotes office which discontinued transactions with Al Rajhi Bank, but not others, such as HSBC Bank Middle East which continued doing business with Al Rajhi Bank and other Al Rajhi entities.<sup>1234</sup> The Subcommittee

<sup>1231</sup> 12/6/004 email from HBUS Alan Ketley to HSBC Christopher Lok, HBUS Stephen Allen, and others, “KYC Profiles – Impact of CO Denial,” HSBC OCC 3185023-025.

<sup>1232</sup> 1/4/2005 email from Teresa Pesce to Daniel Jack, “KYC Status of Profiles for Banknotes by Office: December 2004,” HSBC OCC 2405588.

<sup>1233</sup> Id.

<sup>1234</sup> See, e.g., 1/4/2005 email from Teresa Pesce to Daniel Jack, “KYC Status of Profiles for Banknotes by Office: December 2004,” HSBC OCC 2405588. See also, e.g., 11/17/2006 email from Salman Hussain to David Illing, Gordon Brown, Stephen Allen, and others, “Al Rajhi Bank KYC & AML Policy,” HSBC OCC 3280496-497; 11/17/2006 email from HBUS Stephen Allen to HBUS Beth Fisher and Alan Ketley, “Al Rajhi Banking,” HSBC OCC 3280505 (both emails



asked but has received no explanation as to why the decision bound HSBC affiliates in the United States and Europe, but appeared to not apply to the Middle East.

Soon after the decision was announced in January 2005, HSBC Group Compliance began to narrow its scope. On February 22, 2005, Paul Plesser, head of the HBUS Global Foreign Exchange Department, sent an email to a colleague asking whether, despite the HSBC Group Compliance decision, his office could continue to engage in foreign exchange trades with Al Rajhi Trading Establishment.<sup>1235</sup> He was told by a trader from the Banknotes department: “For us is business as usual.”<sup>1236</sup> Mr. Plesser double-checked with HBUS AML Compliance officer Alan Ketley, asking in an email: “so I guess we are ok to continue trading?”<sup>1237</sup> On March 16, 2005, Mr. Ketley affirmed that the trades could continue, forwarding an email from Ms. Pesce, head of HBUS AML Compliance, stating that the earlier HSBC Group decision no longer applied to Al Rajhi Trading:

“Group has clarified the Al Ra[jh]i guidance issued last month. They have evaluated Al Ra[jh]i Banking and Al Ra[jh]i Trading and now believe that the two are separated enough that relationships may be maintained with the latter but not with the former. To be clear, recommendation is to sever with Banking only at this time.”<sup>1238</sup>

Mr. Ketley commented: “Looks like you’re fine to continue dealing with Al Rajhi. You’d better be making lots of money!”<sup>1239</sup>

In May 2005, four months after announcing the decision to sever ties with Al Rajhi Bank, HSBC Group Compliance backed down still further. It announced that HSBC affiliates could re-establish business ties with Al Rajhi Bank, though subtly suggested that HBUS might not. David Bagley, head of HSBC Group Compliance, announced the decision in a May 23 email sent to HSBC personnel:

“Having now received the updated KYC from Shariq Siddiqi and reviewed the previous information received from Group Securities

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indicating that, in late 2006, HSBC business with Al Rajhi Bank was “substantial,” including through the “HSBC Amanah business”).

<sup>1235</sup> 2/22/2005 email from Paul Plesser to Georges Atallah, “Al Ra[jh]i Trading/Al Ra[jh]i Banking,” HSBC OCC 3111888.

<sup>1236</sup> 2/22/2005 email from Georges Atallah to Paul Plesser and others, “Al Ra[jh]i Trading/Al Ra[jh]i Banking,” HSBC OCC 3111888.

<sup>1237</sup> 2/22/2005 email from Paul Plesser to Alan Ketley, “Al Ra[jh]i Trading/Al Ra[jh]i Banking,” HSBC OCC 3111888.

<sup>1238</sup> 3/16/2005 email from Alan Ketley to Paul Plesser, “Fw: Al Ra[jh]i Guidance Clarified,” HSBC OCC 3114022.

<sup>1239</sup> Id.

I am pleased to confirm that we have revised our recommendation in relation to the above.

Accordingly we have lifted our recommendation against the commence or expansion of relationships with the above with immediate effect.<sup>1240</sup> We will communicate this decision to HBEU [HSBC Europe] where I believe there are a number of pending applications.

Whilst we will advise HBUS CMP [Compliance] of the revised view within GHQ CMP [Group Headquarters Compliance] nevertheless I believe it will remain appropriate for HBUS CMP in conjunction with HBUS senior management to reach their own determination with regard to the expansion of business with Al Rajhi within the US. Although the revised view from GHQ CMP ought to be a material matter causing them to reconsider their position nonetheless, and particularly in the current US environment, I do not believe it is appropriate for us to seek to influence their determination one way or the other.”<sup>1241</sup>

The effect of this decision was to allow HSBC affiliates to do business with Al Rajhi Bank if they chose, which meant HBUS Compliance had to determine for itself whether or not to re-establish ties with Al Rajhi.<sup>1242</sup>

#### **G. 2006: HBUS Banknotes Account Reinstated**

Although HBUS Compliance in the United States held out almost two years, after a concerted campaign by HBUS Banknotes personnel, it ended up following the lead of HSBC Group Compliance and restoring the Al Rajhi Bank account at HBUS in late 2006. One precipitating event appears to have occurred in November 2006, when Al Rajhi Bank threatened to pull all business from HSBC, unless the U.S. banknotes services were restored. Within a month, the account was reestablished.

The two HBUS bankers who spearheaded the effort to restore the Al Rajhi account were Christopher Lok, head of the HSBC Global Banknotes Department, working from New York, and Stephen Allen,

<sup>1240</sup> The new decision lifted the ban on relationships with both Al Rajhi Bank and Al Rajhi Commercial Foreign Exchange, another money exchange business owned by Abdullah Abdul Al Rajhi. The decision on Al Rahhi Commercial Foreign Exchange was in addition to the earlier decision allowing relationships with Al Rajhi Trading Establishment.

<sup>1241</sup> 5/23/2005 email from HSBC David Bagley to HSBC colleagues, “Al Rajhi Bank,” OCC-PSI-00144350, at 2.

<sup>1242</sup> At almost the same time, HSBC CIMB-Institutional Banking, which is part of HSBC Amanah, approved additional banking services for Al Rahji Bank, including trade, treasury, SWIFT wire transfers, foreign exchange, and asset management services. See 5/23/2005 document prepared by CIBM-Institutional Banking on Al Rajhi Banking and Investment Corporation, HSBC OCC 0659988-997, at 8.

head of the HBUS Banknotes branch in London. For more than 20 years, the London office had supplied physical U.S. dollars to Al Rajhi Bank in Saudi Arabia, until forced to stop by the January 2005 decision.

When HSBC Group Compliance reversed the decision on Al Rajhi Bank for HSBC affiliates on May 23, 2005, HSBC Banknotes personnel expressed a desire to reopen their accounts with Al Rajhi Bank as well, while signaling a willingness to wait until the conclusion of an upcoming Global Banknotes examination by the OCC.<sup>1243</sup> On May 23, 2005, Mr. Allen, head of the London Banknotes office, forwarded the HSBC Group Compliance email regarding Al Rajhi Bank to Mr. Lok, head of the Global Banknotes Department, stating: “We’ll have to see if this will make any difference!”<sup>1244</sup> Mr. Lok, in turn, sent an email to Ms. Pesce, head of HBUS AML Compliance, stating: “After the OCC close out and that chapter hopefully finished, could we re-visit Al Rajhi again. London compliance has taken a more lenient view.”<sup>1245</sup>

The on-site work for the OCC AML examination concluded about a month later,<sup>1246</sup> and the HBUS London branch shortly thereafter began to discuss plans to speak with HBUS AML Compliance to allow it to resume ties with Al Rajhi Bank. In a July 2005 meeting to discuss KYC issues, members of the HBUS London Banknotes office discussed both the results of the OCC examination and next steps to discuss the future of HSBC’s relationship with Al Rajhi Bank:

“DJ [Daniel Jack]: We gave the OCC 108 client files. The primary focus of their finding[s] boiled down to 18 files concentrating on the money service business[es] and high risk clients. We obtained a satisfactory rating from the OCC although their examiners identified 5 issues considered ‘Matters Requiring Attention’ with urgency.”<sup>1247</sup> ...

**Saudi:** We lost Al Rajhi this year – we discussed this in various compliance meetings already. SA [Stephen Allen] – a resumption decision was put off because of the OCC audit. CL [Christopher Lok] to speak to SA after the OCC. Allen to speak to Terry [Pesce] before his holidays. Al Rajhi threatened to pull any new

<sup>1243</sup> See 5/15/2006 OCC letter to HBUS (“On June 12, 2006 we will begin a 3-week Examination of Global Banknotes, London. We hope to complete on site work on or before June 30, 2006.”).

<sup>1244</sup> 5/23/2005 email from HBUS Stephen Allen to HSBC Christopher Lok, “Al Rajhi,” OCC-PSI-00144350, at 1-2.

<sup>1245</sup> 5/23/2005 email from HSBC Christopher Lok to HBUS Teresa Pesce, “Al Rajhi,” OCC-PSI-00144350, at 1.

<sup>1246</sup> 6/20/2005 OCC Supervisory Letter, Global Banknote examination of HSBC, USA, OCC-PSI-00107505. [Sealed Exhibit.]

<sup>1247</sup> The MRAs cited by the OCC required the London Banknotes Office to conduct a client file review to improve client information and analysis; review client risk ratings; add expected client account activity to the client files; revise written procedures to include the need to obtain expected client activity; and improve AML training in these areas. Id.

business with HSBC, unless we give them a satisfactory reason why we won't trade banknotes with them."<sup>1248</sup>

Al Rajhi Bank communicated the threat to "pull any new business with HSBC" unless given a "satisfactory explanation" why HSBC had stopped supplying it with U.S. dollars via its relationship managers.<sup>1249</sup> That threat was not mentioned again in the documents provided to the Subcommittee.

The next month, in August 2005, Mr. Allen sent Sally Lomas, KYC manager for the London Banknotes office, a copy of the Lok email asking HBUS AML Compliance to re-visit the Al Rajhi issue, together with the HSBC Group Compliance email allowing re-establishment of the relationship for the rest of HSBC. Ms. Lomas forwarded the emails to Lynda Cassell, then a senior Compliance official at HBUS. Ms. Lomas wrote:

"Please find attached an email sent by David Bagley, indicating that there is no longer a recommendation against expanding relationships with Al Rajhi Bank. I have asked Fig [HSBC Financial Intelligence Group] to check, when they do their additional work, whether the same part of the Al Rajhi fa[m]ily is in[vol]ved in both Banks."<sup>1250</sup>

On the same day, Ms. Pesce, head of HBUS AML Compliance, responded to the Lomas email, warning that re-opening the Al Rajhi Bank account should not be viewed as an easy decision:

"This is not so simple. David [Bagley] does not object insofar as HBEU [HSBC Europe] is concerned, but has left it to us to assess the US risk. We've gotten push back from the OCC on Al Rahji Trading, which is less controversial than the bank. We can revisit this, but I am not inclined to push ahead precipitously, especially in light of the regulatory scrutiny."<sup>1251</sup>

In January 2006, the Banknotes Department tried again. Minutes of a London Banknotes meeting to discuss KYC issues recorded the following discussion:

"Banknotes-London would like to resume business with Al Rajhi, although we have ceased trading (due to rumours in terrorist financing, the U.S. Government has now dropped those charges ...)[.] [T]he rest of the HSBC group still deal with them. LC

<sup>1248</sup> 7/12/2005 "HBUS London Banknotes Minutes of KYC Review Meeting," OCC-PSI-00835857, at 1, 4 (emphasis in original).

<sup>1249</sup> Subcommittee interview of Christopher Lok (3/29/2012) and Alan Ketley (2/16/2012).

<sup>1250</sup> 8/10/2005 email from Sally Lomas to Lynda Cassell with copies to Teresa Pesce, Alan Ketley, Stephen Allen, and others, "Al Rajhi," OCC-PSI-00343527.

<sup>1251</sup> 8/10/2005 email from Teresa Pesce to Sally Lomas and others, "Al Rajhi," OCC-PSI-00343527.

[Lynda Cassell] advised a conference call with Terry [Pesce] is needed but before this takes place LC would like to see a memo from SA [Stephen Allen] about the history of this matter, subsequently Lynda will take this memo to Terry to arrange the conference call.”<sup>1252</sup>

The minutes reflect that a rumor was circulating among several HSBC officials that the U.S. government had “dropped” charges of terrorist financing against the bank, which was not the case since no formal charges had ever been filed. The minutes also indicate that all HSBC affiliates were then allowed to do business with Al Rajhi Bank other than HBUS, a fact used at one point to try to convince HBUS Compliance to allow the account.

In February 2006, Mr. Allen met with Lynda Cassell, a senior AML policy advisor, about Al Rajhi Bank.<sup>1253</sup> That same month, Gordon Brown, who had taken over London Banknotes KYC issues from Susan Lomas, provided Ms. Cassell with a copy of Al Rajhi Bank’s AML policies and procedures.<sup>1254</sup> Ms. Cassell responded with an email to Mr. Brown, Mr. Allen, and others explaining:

“Gordon, in accordance to our previous conversation, the AML compliance decision to do business with Al Rajhi lies with Terry Pesce and as suggested, Stephen [Allen] should speak to Terry regarding his desire to enter into a Banknotes relationship. ... In regards to Al Rajhi’s AML Policy and Procedures, I find them comprehensive .... Their high risk client base generally mirrors our high risk type clients.”<sup>1255</sup>

In March 2006, Mr. Allen and Mr. Brown exchanged emails with Mr. Ketley, a senior HBUS AML Compliance officer who worked for Ms. Pesce.<sup>1256</sup> Mr. Allen wrote:

“[A]ccording to Al Rajhi, their senior management had been advised by the US State Department that they were no longer considered to be under suspicion and I was wondering whether HBUS Compliance or Security may have a contact at State ... that could be explored to verify this statement?”<sup>1257</sup>

<sup>1252</sup> 1/26/2006 “HBUS London Banknotes Minutes of KYC Review Meeting,” OCC-PSI-00835851, at 3.

<sup>1253</sup> See 3/21/2006 email from HSBC Stephen Allen to HBUS Alan Ketley and Gordon Brown, “AL Rajhi,” HSBC OCC 0695040.

<sup>1254</sup> 2/6/2006 email from HSBC Gordon Brown to HBUS Lynda Cassell, “AML Procedures: Al Rajhi Banking & Investment Corp., Saudi Arabia,” HSBC OCC 3250665-667, at 667.

<sup>1255</sup> 2/8/2006 email from HBUS Lynda Cassell to HSBC Gordon Brown and others, “AML Procedures: AlRajhi Banking & Investment Corp., Saudi Arabia,” HSBC OCC 3250665-667, at 666.

<sup>1256</sup> 3/20/2006 email exchange between HBUS Alan Ketley and HSBC Stephen Allen and Gordon Brown, “AL Rajhi,” HSBC OCC 0695040.

<sup>1257</sup> Id. It is unclear what his email referred to when it said that the State Department told the bank that it was no longer “under suspicion.”

Mr. Ketley agreed to try to verify the information, and Mr. Allen responded:

“Thanks Alan, anything that you can do is appreciated as, with the summer heat approaching, this client becomes very active and is commercially extremely important to us – if we can ever get to re-start our business with them that is. You may recall me telling you that we dealt with Al Rajhi for 30 years prior to being obliged to desist!”<sup>1258</sup>

Also in March 2006, Beth Fisher, an HBUS employee who used to be the corporate relationship manager assigned to Al Rajhi Bank, discovered that HBUS had failed to cancel a \$50 million line of credit for the bank when the relationship ended. She sent an email to Mr. Ketley: “I thought we exited this name!”<sup>1259</sup> He responded: “I gather tha[t] Banknotes wants to revive the relationship but has not yet done so.” The next day, Ms. Fisher explained to a colleague: “FYI, this was an HBUS London Banknotes (only) relationship which was exited a year ago due to AML Compliance concerns. ... This is NO LONGER an HBUS relationship. We must remove this bank from our list.”<sup>1260</sup>

In April 2006, Susan Wright, head of AML Compliance for the entire HSBC Group, weighed in, sending an email to Ms. Pesce and Mr. Ketley asking, “what the position is with regard to the possibility of a Bank Note relationship in London” with Al Rajhi?<sup>1261</sup> Ms. Pesce responded: “It still makes me nervous. Alan has gone out to Steve Allen for more KYC/EDD [Know Your Customer/Enhanced Due Diligence].” Mr. Ketley told the Subcommittee that the Al Rajhi Bank relationship was the only one where he was influenced by HSBC Group.<sup>1262</sup>

That same day, April 10, 2006, Lynda Cassell sent an email to Mr. Allen at London Banknotes requesting information about whether Al Rajhi Bank did business in countries subject to OFAC sanctions and how they would use U.S. banknotes, if they were restored.<sup>1263</sup> He arranged for an inquiry to be sent to Al Rajhi Bank which then took five months to respond with limited information.<sup>1264</sup> For example, in

<sup>1258</sup> 3/21/2006 email from HSBC Stephen Allen to HBUS Alan Ketley and Gordon Brown, “AL Rajhi,” HSBC OCC 0695039.

<sup>1259</sup> 3/20/2006 email from HBUS Beth Fisher to HBUS Alan Ketley, “Al Rajhi,” HSBC OCC 3224893.

<sup>1260</sup> 3/21/2006 email from HBUS Beth Fisher to HBUS Dorothy Gulman, Alan Ketley and others, “Re: Updated TSO/TCS2 spreadsheet,” HSBC OCC 3225386.

<sup>1261</sup> 4/18/2006 email exchange between HSBC Susan Wright and HBUS Teresa Pesce, “Al Rajhi,” HSBC OCC 4827027.

<sup>1262</sup> Subcommittee interview of Alan Ketley (2/16/2012).

<sup>1263</sup> 4/10/2006 email from HBUS Lynda Cassell to HBUS Stephen Allen, “Al Rajhi Banking & Investment Corp., Saudi Arabia,” HSBC OCC 3250665.

<sup>1264</sup> 9/17/2006 email from Al Rajhi Bank Mohd Fazal Haque to HSBC Salman Hussain, “HSBC Bank Middle East Limited,” HSBC OCC 3280498-499.

response to a question asking the bank to “confirm the countries outside of Saudi Arabia that you do business with,” Al Rajhi Bank wrote: “All our correspondent banks['] names are available in the Bankers Almanac.”<sup>1265</sup> When asked how the bank ensures it does not utilize HBUS products or services in countries that are “OFAC-sanctioned,” the bank’s entire response was: “We apply strict due diligence and KYC procedures to high risk countries.”<sup>1266</sup> Both replies did not sufficiently answer the questions posed.

The bank provided a slightly longer answer when asked how it would use U.S. banknotes:

“All USD banknotes we purchase [are] for our own branches['] use. ... [W]e have a big population of around 7 million foreign workers in the kingdom who mostly prefer USD when traveling back to their countries on vacation or even when remitting money to their families .... Also during summer time we have a high demand from tourist[s] traveling for their vacations.”<sup>1267</sup>

This response suggested that, if resupplied with U.S. dollars, the bank would provide those dollars to a wide group of persons in Saudi Arabia, many of whom would be expected to transport the dollars across international borders into other countries.

In June 2006, HSBC Bank Middle East added its voice to that at the Banknotes group in pushing for the account to be reopened. Salman Hussain, then Payments and Cash Management (PCM) Regional Sales Manager for HSBC Bank Middle East, sent an email to Mr. Ketley at HBUS AML Compliance highlighting the potential revenue if Al Rajhi Bank were to be reinstated as a banknotes customer:

“I am sending you this email seeking your assistance to address any issues pertaining to Al Rajhi Bank in order to obtain compliance approval. ... As I understand from talking to all parties that we had an excellent relationship with Al Rajhi Bank until year 2004, banknote[s] (David Illing) stopped doing business while being the largest revenue generator in the Middle East. Amanah Finance in London (Emran Ali Reza) still trade[s] with Al Rajhi Bank .... From my side, I would like to use the Islamic Overnight Investment [product] ... as an intro to this bank. The amount of potential business/revenue is quite substantial ....”<sup>1268</sup>

<sup>1265</sup> Id. at HSBC OCC 3280498.

<sup>1266</sup> Id.

<sup>1267</sup> Id. at HSBC OCC 3280499.

<sup>1268</sup> 6/22/2006 email from HBME Salman Hussain to HBUS Alan Ketley with copies to others in HSBC, “Al Rajhi Banking & Investment Corp. (Al Rajhi Bank), Saudi Arabia,” HSBC OCC 3250655.

Mr. Hussain sent copies of his email to six colleagues in various HSBC departments.

Mr. Ketley responded to Mr. Hussain on the same day as follows:

"This must be the week for Al Rajhi as yours is the second e-mail about the bank that I have received.

HBUS exited the relationship in 2004 primarily for Compliance reasons. Earlier this year, Banknotes London expressed their desire to re-establish the relationship and there has been a fair amount of discussion about whether or how to do this. ...

[C]ertain questions ... need to be addressed before any Compliance decision can be made about resuming the relationship. For your information, Banknotes London has been fully embroiled in (preparing for and now in the midst of) an OCC exam so are unlikely to have been able to pursue these questions.

The concerns about this name in the US have been rather long standing and we will need to get extremely comfortable with Al Rajhi before we would be willing to re-establish a relationship."<sup>1269</sup>

In June 2006, the OCC completed the on-site work for its AML examination of the London Banknotes Office and, in September, sent a Supervisory Letter to HBUS summarizing the results and directing the London office to improve its Know Your Customer information and client risk ratings.<sup>1270</sup>

Also in June 2006, Emma Lawson, who worked for Susan Wright, head of AML Compliance for the HSBC Group, sent an email to Mr. Ketley and Ms. Pesce inquiring about progress on the Al Rajhi Bank account.<sup>1271</sup> Mr. Ketley responded that they had yet to receive answers to certain AML questions, in part because London Banknotes personnel "have been fully engaged on an OCC exam for the past few months. The exam will end on June 30 so I expect they will revisit the subject then."<sup>1272</sup>

In July 2006, the London Banknotes office held a meeting to discuss its business activities and prospects, and again brought up Al Rajhi Bank. A summary of the meeting stated:

<sup>1269</sup> 6/22/2006 email from HBUS Alan Ketley to HBME Salman Hussain and others in HSBC, "Al Rajhi Banking & Investment Corp., Saudi Arabia," HSBC OCC 3250655.

<sup>1270</sup> See 9/26/2006 OCC Supervisory Letter HSBC-2006-29, "London Global Banknote BSA/AML Examination," OCC-PSI-0010755-760. [Sealed Exhibit.]

<sup>1271</sup> 6/20/2006 email from HSBC Emma Lawson to HBUS Alan Ketley and Teresa Pesce, "Al Rajhi Banking & Investment Corp., Saudi Arabia," HSBC OCC 3281773-774.

<sup>1272</sup> 6/20/2006 email from HBUS Alan Ketley to HSBC Emma Lawson and Teresa Pesce, "Al Rajhi Banking & Investment Corp., Saudi Arabia," HSBC OCC 3281773-774.



**“Saudi Arabia ...** [W]e are experiencing a lot of competition from Commerz [Bank] who are shipping [U.S. dollars] directly from NY [New York] into Saudi and they are offering nearly 50% cheaper prices than BN [Banknotes] quote, so work has had to be done to offer better prices to re-gain volume in this business. We only have two customers here ... but we continue to press for the re-instatement of Al Ra[jh]i but there remain ongoing KYC issues.”<sup>1273</sup>

In the fall, at the request of Gordon Brown, KYC manager at the London Banknotes office, the HSBC Financial Intelligence Group (FIG) provided an update to an existing investigative report on Al Rajhi Bank.<sup>1274</sup> The report was only three pages long and consisted primarily of information taken from publicly available publications about the bank’s ownership and management. The report also noted that a U.S. judge had dismissed the bank from a lawsuit brought by victims of the 9/11 terrorist attack, and that the World-Check database had listed the bank’s Chairman and Managing Director Sulaiman Abdul Aziz Al Rajhi under its category for “terrorism.”<sup>1275</sup>

Following receipt of the report, the KYC customer profile was updated by the HBUS Banknotes Department for Al Rajhi Bank with a view toward reinstating the account. The profile stated in part:

“A multitude of allegations have surrounded the Al-Rajhi family implicating them in a gamut of highly adverse activities ranging from money laundering to terrorist financing. The current facts, however, do not easily support these allegations. Presently, no U.S. or foreign government law enforcement or regulatory body has stated, unconditionally, that any member of Al-Rajhi or any company controlled by Al-Rajhi is under sanction. The U.S. continues to pursue relationship with Saudi Arabia and the Al-Rajhi family irregardless of the allegations being levied against charitable institutions with some presumably direct and indirect links to Al-Rajhi. The major 9/11 lawsuit, which included Al-Rajhi, has been dropped against the family and family-related institutions.

However, there is some reputational risk and the possibility that further investigations by U.S. authorities may ultimately uncover substantiating proof of the Al-Rajhi connection to terrorism is

<sup>1273</sup> 7/24/2006 “2Q06 London Banknotes Review Meeting,” HBUS London Banknotes branch, HSBC OCC 2691117-124, at 122 (emphasis in original).

<sup>1274</sup> 10/24/2006 email from FIG Michael Ellis to HBUS Gordon Brown and others, “Report of Findings – Al Rajhi Banking & Investment Corp. – FIG,” HSBC OCC 7519403-406.

<sup>1275</sup> Id. at 405-406.

certainly a concern. Our account relationship with Al-Rajhi will be primarily selling USD banknotes out of London. The risk of future sanctions and the reputational risk based on the aforementioned allegations should be measured against the current risks involved in our relationship when ultimately deciding our course of action. Therefore, London Banknotes feels that the bank poses minimal reputational risk to us.”<sup>1276</sup>

This justification for renewing the account relationship had two key features. First, it asserted that, despite many allegations, no government had stated “unconditionally” that Al Rajhi Bank or its owners were under sanction for financing terrorism. Second, it focused on “current risks” and asserted that, measured against those, Al Rajhi Bank posed only “minimal” reputational risk to HSBC.

On November 14, 2006, Christopher Lok, head of Global Banknotes, submitted the new profile for approval to Beth Fisher, the HBUS corporate relationship manager formerly assigned to Al Rajhi Bank.<sup>1277</sup> Ms. Fisher responded to Mr. Lok, with a copy to Mr. Ketley and Mr. Jack in HBUS AML Compliance, “I thought this was an HSBC exit name.”<sup>1278</sup> Mr. Ketley replied to her, “It was exited once (2004?) – Banknotes London is looking to reopen the relationship.” He also stated: “The profile had better be bullet proof.”<sup>1279</sup>

Three days later, Mr. Allen sent Ms. Fisher and Mr. Ketley an email urging them to expedite their review of the client profile, which he hoped would reestablish the account, citing a threat by Al Rajhi Bank to pull all business from HSBC unless the U.S. banknotes services were restored:

“Salman Hussain, the PCM [Payments and Cash Management] Regional Sales Manager at HBME [HSBC Bank Middle East] in Bahrain, who has recently visited the subject, has called to say that Al Rajhi has now run out of patience waiting for us to re-start our banknote trading relationship and unless we can complete the kyc formalities and advise them accordingly by the end of November, they will terminate all product relationships with the HSBC Group – which I believe to be substantial.

<sup>1276</sup> 2010 HSBC KYC Profile of Al Rajhi Bank, at 11-12. HSBC KYC profiles are evolving documents that retain past information stretching back multiple years.

<sup>1277</sup> 11/14/2006 email from HSBC Christopher Lok to HBUS Beth Fisher, “KYC Approval needed for: Al Rajhi Banking & Investment Corp,” HSBC OCC 3279589-590.

<sup>1278</sup> 11/14/2006 email from HBUS Beth Fisher to HSBC Christopher Lok and HBUS Alan Ketley, “KYC Approval needed for: Al Rajhi Banking & Investment Corp,” HSBC OCC 3279589.

<sup>1279</sup> 11/14/2006 email from HBUS Alan Ketley to HBUS Beth Fisher, “KYC Approval needed for: Al Rajhi Banking & Investment Corp,” HSBC OCC 3279589.

Their main point of contention is that they feel that they were exonerated by all US legal processes from TF [Terrorist Financing] suspicion some time ago and yet we have still not been able to re-start trading with them. Gordon [Brown] finished our latest attempt at the profit on Tuesday and you will find the kyc profile to be currently in the 'IB Pending' inbox. Could I please ask you both to expedite your reviews so that we can attempt to prevent the loss of an important client to the Group?"<sup>1280</sup>

Later in the day, Mr. Allen forwarded to Ms. Fisher and Mr. Ketley an email that had been sent by Mr. Hussain after he met with the bank in Riyadh, Saudi Arabia.<sup>1281</sup> Mr. Hussain had sent the email to Mr. Allen and other colleagues, informing them that Cassim Docrat, an Al Rajhi Bank representative, had told him that if the U.S. banknotes business wasn't reestablished by the end of November, Al Rajhi Bank would "cancel any business dealings with HSBC."<sup>1282</sup> His email also stated that the bank had indicated it had been able to procure a large line of credit from one of HSBC's competitors, JPMorganChase. Mr. Hussain wrote:

"I can't stress on the fact that we do want to do business with this institution from PCM [Payments and Cash Management] side. We do stand a good chance to win a US\$ clearing account thru offering Islamic Overnight Investment Product and the US \$ checking clearing thru Check 21."<sup>1283</sup>

Mr. Allen also sent a copy of Mr. Hussain's email to Mr. Lok, commenting: "As ever, we are taking an inordinate amount of time to make our minds up. I discussed this client with Terry [Pesce], Linda [Cassell] and Alan [Ketley] when I visited in February, we eventually received and have now answered a rate of supplementary questions from Linda and now that she has left, no doubt there will be more questions from Alan!"<sup>1284</sup> Mr. Lok responded:

"I would tell Salman that he should relay the 'concern' Alrajhi has expressed to the higher ups. To cancel the Amanah business is much bigger than not dealing with banknotes. Hopefully

<sup>1280</sup> 11/17/2006 email from HBUS Stephen Allen to HBUS Beth Fisher and Alan Ketley, "Al Rajhi Banking," HSBC OCC 3280504-505.

<sup>1281</sup> 11/17/2006 email from Salman Hussain to David Illing, Gordon Brown, Stephen Allen and others, "Al Rajhi Bank KYC & AML Policy," HSBC OCC 3280496-497. Mr. Salman was meeting with the bank, because HSBC Bank Middle East had never ceased doing business with it.

<sup>1282</sup> 11/17/2006 email from Salman Hussain to David Illing, Gordon Brown, Stephen Allen and others, "Al Rajhi Bank KYC & AML Policy," HSBC OCC 3280496-497.

<sup>1283</sup> Id.

<sup>1284</sup> 11/17/2006 exchange between HBUS Stephen Allen to HSBC Christopher Lok, "Alrajhi," OCC-PSI-00150798.

somebody in London will listen and given NYK [New York] Compliance a gentle push.”<sup>1285</sup>

That afternoon, Ms. Fisher sent an email to Mr. Allen declining to approve the new Al Rajhi Bank client profile:

“I am not trying to be difficult, but I do not personally feel comfortable [being the] IB [institutional banker] approving this name. I do not know this bank. Additionally, several years ago, when HBUS had relationships with 2 different Al Rajhi names, management would ask me questions about the customer every time the name appeared in the US newspapers. I do not know this bank personally and therefore not qualified to render an opinion. ... Therefore, please ask another officer to IB approve. I am IB-Denied the KYC, so that my name can be removed as RM [relationship manager].”<sup>1286</sup>

Mr. Allen responded: “I quite understand your position and I will try another tack.”<sup>1287</sup>

After receiving her refusal to approve the Al Rajhi Bank profile, Mr. Allen forwarded it to Mr. Lok and asked: “[W]ho do you suggest can/will sign this profile? You will see that it is pressing – perhaps David [Wilens] could IS and you could IB approve if Susan [Wright] and I sign it again?”<sup>1288</sup> Mr. Lok responded: “At the end of the day, its compliance who’s the key. I’ll speak to Ketley & ask him to re-evaluate this name.”<sup>1289</sup> Mr. Lok also sent an email to Mr. Allen informing him: “Just spoke to Alan [Ketley]. He’s going to read the whole file ... and he’s aware of the ‘threat’ you passed along. His view is Alrajhi may not really walk away if we can’t revert by November end, which I agree. ... W[e] should have an answer in the next few weeks.”<sup>1290</sup>

Over the next few days, Mr. Ketley reviewed Al Rajhi Bank’s AML policies and procedures. He also asked Mr. Hussain: “What revenue projections do you have associated with the US\$ clearing and Check 21 ‘cash letter’” services that could be provided by HBUS to Al

<sup>1285</sup> Id.

<sup>1286</sup> 11/17/2006 email from HBUS Beth Fisher to HBUS Stephen Allen, Alan Ketley, Christopher Heusler, “Al Rajhi Banking,” HSBC OCC 3280504.

<sup>1287</sup> 11/17/2006 email from HBUS Stephen Allen to HBUS Beth Fisher, Alan Ketley, Christopher Heusler, “Al Rajhi Banking,” HSBC OCC 3280504.

<sup>1288</sup> 11/17/2006 email from HBUS Stephen Allen to HSBC Christopher Lok and David Wilens, “Al Rajhi Banking,” OCC-PSI-00150795. In a Subcommittee interview, Mr. Lok explained that he retained the authority to act as the institutional banker for a client and so could approve a client profile. Subcommittee interview of Christopher Lok (3/29/2012). David Wilens was the chief operating officer of the London Banknotes office and later became chief operating officer for the entire HBUS Banknotes Department. See Nov. 2006 HBUS organizational chart, OCC-PSI-00000501, at 505.

<sup>1289</sup> 11/17/2006 email from HSBC Christopher Lok to HBUS Stephen Allen and HSBC David Wilens, “Al Rajhi Banking,” OCC-PSI-00150795.

<sup>1290</sup> 11/17/2006 email from HSBC Christopher Lok to HBUS Stephen Allen, “Alrajhi,” OCC-PSI-00150796.

Rajhi Bank?<sup>1291</sup> Mr. Hussain responded: “Estimated revenue will be a minimum of \$100k per annum.”

Emma Lawson, in AML Compliance at HSBC Group Headquarters, also sent an email to Mr. Ketley asking, “Has progress been made.”<sup>1292</sup> Mr. Ketley responded:

“Your timing is uncanny and I suspect not entirely unrelated to correspondence last week from Banknotes and PCM. I have reviewed the new documentation provided by the client and discussed it with Terry [Pesce] – she has indicated a desire to discuss with David. Will keep you posted.”<sup>1293</sup>

A later email indicated that Ms. Pesce also raised the matter with “the Bank’s executive management.”<sup>1294</sup>

On December 1, 2006, Mr. Ketley sent an email to Mr. Allen and Salman Hussain, with copies to Ms. Pesce and Mr. Lok, indicating he would approve re-opening the banknotes account with Al Rajhi Bank:

“[T]he purpose of this note is to confirm to you the willingness of HBUS to recommence a relationship with Al Rajhi Bank. ...

[I] am satisfied that we can do business with this entity as long as our due diligence is thoroughly documented and close transaction monitoring takes place by Compliance along with a high degree of transaction awareness being maintained by the business. Over a period of years there has been much negative publicity associated with the principals of this entity – while none of these allegations has been proven or substantiated, the notion of ‘no smoke without fire’ is one we must bear in mind and any business unit dealing with this entity must acknowledge the associated risks. ... [T]o paraphrase an expression from English Banking, if it is in my hand and in order I will approve it.”<sup>1295</sup>

<sup>1291</sup> 11/20/2006 email from HBUS Alan Ketley to HSBC Salman Hussain, with copies to Stephen Allen, Gordon Brown, and others, “Re: Fw: Al Rajhi Bank KYC & AML Policy,” HSBC OCC 3280945.

<sup>1292</sup> 6/20/2006 email exchange between HSBC Emma Lawson and HBUS Alan Ketley, “Fw: Al Rajhi Banking & Investment Corp., Saudi Arabia,” HSBC OCC 3281773-774.

<sup>1293</sup> Id. Teresa Pesce, then HBUS AML head, told the Subcommittee that she didn’t recall any specific pressure exerted by HSBC Group with regard to the Al Rajhi Bank relationship, but she knew that HSBC Group was interested in maintaining it. Subcommittee interview of Teresa Pesce (3/30/12).

<sup>1294</sup> 6/3/2008 email from HBUS Denise Reilly to HBUS Alan Williamson, Daniel Jack, Anne Liddy and others, “Banknotes with Al Rajhi Banking in S.A.,” HSBC OCC 1638575. Ms. Pesce told the Subcommittee that the United States initially raised the idea of exiting the Al Rajhi relationship. She said she may have raised it with Susan Wright, David Bagley, and “the board.” Subcommittee interview of Teresa Pesce (3/30/2012).

<sup>1295</sup> 12/1/2006 email from HBUS Alan Ketley to HBUS Stephen Allen, HSBC Salman Hussain, and others, “Al Rajhi Bank,” OCC-PSI-00150892. Ms. Pesce told the Subcommittee that a court dismissal of claims against the bank was the single most important reason that she decided to re-open the relationship. Both Mr. Ketley and Ms. Pesce stated that they did due diligence on Al Rajhi Bank, and both thought that the risk could be managed and that they made sure the

Mr. Ketley also placed several conditions on the approval of the client profile, noting that his approval extended only to banknotes transactions and not to cash letter transactions. He also stated that the bank could engage in wire transfers, but “I cannot support paper activity with the degree of close monitoring that would be appropriate.”<sup>1296</sup>

Mr. Ketley noted that Christopher Lok, head of Global Banknotes, would act as the “relationship owner” of the account in place of Beth Fisher, and would “approve the profile if he is satisfied with it.”<sup>1297</sup>

Mr. Ketley announced the decision to reopen the Al Rajhi Bank account despite, in the words of the 2006 client profile, a “multitude of allegations ... implementing [Al-Rajhi] in a gamut of highly adverse activities ranging from money laundering to terrorist financing.” The decision was also made despite the refusal of the prior Al Rajhi Bank relationship manager, Beth Fisher, to approve the profile, and immediately after HSBC learned that the outside KYC database it relied on for due diligence, World Check, had identified Al Rajhi Bank’s most senior official as linked to terrorism. The decision also came one year after a 2005 U.S. indictment provided a concrete example of Al Rajhi Bank’s alleged link to terrorism, disclosing how senior officials from al-Haramain Foundation Inc. had cashed \$130,000 in U.S. travelers cheques at Al Rajhi Bank in Saudi Arabia and then smuggled the money to violent extremists in Chechnya.<sup>1298</sup>

The 2006 client profile focused on the fact that no country had indicted, issued a terrorist-related designation, or sanctioned Al Rajhi Bank or its owners, even though that was also true in 2005, when the original decision to close the account was made. The internal HSBC emails indicate that two other major factors in the decision to restore the account were the threat made by Al Rajhi Bank to withdraw its business, and the promise of new revenue exceeding \$100,000 per year.

#### **H. 2007 to 2010: Additional Troubling Information**

The HBUS Banknotes account for Al Rajhi Bank was formally reestablished on December 4, 2006.<sup>1299</sup> Once the account was reinstated, HBUS London Banknotes began supplying an estimated

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regulators were aware of the relationship. Subcommittee interviews of Teresa Pesce (3/30/2012) and Alan Ketley (2/26/2012).

<sup>1296</sup> 12/1/2006 email from HBUS Alan Ketley to HBUS Stephen Allen, HSBC Salman Hussain, and others, “Al Rajhi Bank,” OCC-PSI-00150892. Ms. Pesce confirmed to the Subcommittee that the HBUS relationship with Al Rajhi Bank was limited to a banknotes relationship. Subcommittee interview of Teresa Pesce (3/30/12).

<sup>1297</sup> 12/1/2006 email from HBUS Alan Ketley to HBUS Stephen Allen, HSBC Salman Hussain, and others, “Al Rajhi Bank,” OCC-PSI-00150892.

<sup>1298</sup> “Former U.S. Head of Al-Haramain Islamic Foundation Sentenced to 33 Months in Federal Prison,” U.S. Attorney’s Office for the District of Oregon press release (9/27/11), at 1.

<sup>1299</sup> See 2010 HSBC KYC Profile of Al Rajhi Bank, at 13.

average of \$25 million in physical U.S. dollars per month to Al Rajhi Bank in Saudi Arabia.<sup>1300</sup> HBUS informed the Subcommittee that over the next four years Al Rajhi Bank purchased nearly \$1 billion in U.S. dollars from HBUS, while selling back less than \$10 million. The annual totals are as follows.

	U.S. Dollars Sold to Al Rajhi Bank	U.S. Dollars Purchased from Al Rajhi Bank
2006	\$ 0	\$ 0
2007	\$ 123 million	\$ 8 million
2008	\$ 202 million	\$ 0
2009	\$ 369 million	\$ 0
2010	\$ 283 million	\$ 0
Grand total:	\$ 977 million	\$ 8 million <sup>1301</sup>

During that time period, troubling information about Saudi Arabia in general and Al Rajhi Bank in particular continued to circulate, but neither HSBC nor HBUS engaged in another round of internal deliberations over whether to maintain the account. Instead, HBUS's Hong Kong branch opened a new line of banknotes trading with Al Rajhi Bank.

In July 2007, the Wall Street Journal published two lengthy articles by reporter Glenn Simpson examining Al Rajhi Bank's links to terrorism.<sup>1302</sup> The first article disclosed the existence of the 2003 CIA report, "Al Rajhi Bank: Conduit for Extremist Finance," and quoted its statement that "[s]enior al-Rajhi family members have long supported Islamic extremists and probably know that terrorists use their bank." The article repeated the information that the name of the bank's most senior official, Sulaiman bin Abdul Aziz Al Rajhi, had appeared on al Qaeda's list of 20 early financial benefactors.<sup>1303</sup> After the first article was published, HBUS' primary U.S. regulator, the OCC, asked HBUS to respond to its allegations.<sup>1304</sup>

Also in 2007, reports by the U.S. Department of State<sup>1305</sup> and the Congressional Research Service<sup>1306</sup> stated that Saudi Arabia continued to

<sup>1300</sup> See 7/26/2007 email from HBUS Daniel Jack to HBUS Alan Ketley, "BN-LN with Al Rajhi Bank in Saudi Arabia," HSBC OCC 1413726.

<sup>1301</sup> Subcommittee briefing by HSBC legal counsel (7/9/2012).

<sup>1302</sup> "U.S. Tracks Saudi Bank Favored by Extremists," Wall Street Journal, Glenn Simpson (7/26/2007); "Reported U.S. Concerns over Saudi Bank leave Compliance Officers Reading Tea Leaves," Wall Street Journal, Glenn Simpson (7/27/2007).

<sup>1303</sup> "U.S. Tracks Saudi Bank Favored by Extremists," Wall Street Journal, Glenn Simpson (7/26/2007).

<sup>1304</sup> 7/26/2007 email from OCC Joseph Boss to HBUS Alan Ketley, "Saudi's," HSBC OCC 3391185.

<sup>1305</sup> See 2007 International Narcotics Control Strategy Report, U.S. State Department, at 355.

be a source of financing for Al Qaeda and other terrorist organizations, and expressed particular concern about the use of cash couriers to deliver funds outside of the country. In September, on the sixth anniversary of the 9/11 attack, Treasury Under Secretary Levey said in a televised interview on terrorist financing: “[I]f I could somehow snap my fingers and cut off the funding from one country, it would be Saudi Arabia.”<sup>1307</sup> In August 2007, Congress enacted legislation expressing concern about Saudi Arabia’s uneven role in terrorist financing.<sup>1308</sup>

In April 2008, Treasury Under Secretary Levey testified that, while Saudi Arabia had taken strong action against terrorists operating within its borders and was cooperating with the United States on an operational level, it was not working as hard to prevent funds from flowing to terrorists outside of its borders: “Saudi Arabia today remains the location from which more money is going to terror groups and the Taliban – Sunni terror groups and the Taliban – than from any other place in the world.”<sup>1309</sup>

The 2009 GAO report prepared for Congress stated: “U.S. officials remain concerned about the ability of Saudi individuals and multilateral charitable organizations, as well as other individuals visiting Saudi Arabia, to support terrorism and violent extremism outside of Saudi Arabia.”<sup>1310</sup> Also in 2009, HBUS received an inquiry from the IRS Criminal Investigation Division asking for contact information for the U.S. agent that receives service of process in the United States on behalf of Al Rajhi Bank.<sup>1311</sup> In response, HBUS AML compliance officer Daniel Jack reviewed the bank’s account activity for the prior 12 months. He wrote:

“This bank (an SCC) had a long-standing relationship (25+ years) with Banknotes-London until we closed the account in Feb-05 due to TF [Terrorist Financing] & reputational risk. With approval from AML (A. Ketley), London re-opened the BN [Banknotes] account in Dec-06 with SCC classification due to PEP. This client still has relationships with HSBC in the UK, UAE, France, Hong

<sup>1306</sup> See 2007 CRS Report on Saudi Arabia Terrorist Financing Issues, in the summary.

<sup>1307</sup> “U.S.: Saudis Still Filling Al Qaeda’s Coffers,” ABC News, Brian Ross (9/11/2007).

<sup>1308</sup> See Section 2043(c), Implementing Recommendations of the 9/11 Commission Act, P.L. 110-53 (8/3/2007).

<sup>1309</sup> Stuart Levey testimony before Senate Committee on Finance, “Anti-Terrorism Financing: Progress Made and Challenges Ahead,” (4/1/2008).

<sup>1310</sup> “Combating Terrorism: U.S. Agencies Report Progress Countering Terrorism and Its Financing in Saudi Arabia, but Continued Focus on Counter Terrorism Financing Efforts Needed,” U.S. Government Accountability Office, GAO-09-883 (Sept. 2009), <http://www.gao.gov/new.items/d09883.pdf>, at 29.

<sup>1311</sup> See 5/12/2009 HBUS email exchange, “Al-Rajhi Banking and Investment Corporation, Saudi Arabia,” OCC-PSI-00823520, with attachments.



Kong and Italy. ... Following is a listing of all traders' explanations provided for alerts over the past 7+ years."<sup>1312</sup>

His analysis disclosed that, over the prior 12 months, HBUS had provided Al Rajhi Bank with over \$200 million in U.S. dollars.<sup>1313</sup>

In 2010, the al Haramain Foundation trial got underway related to the cashing of \$130,000 in travelers cheques at Al Rajhi Bank in Saudi Arabia to help violent extremists in Chechnya. Prior to the trial, the United States served a subpoena on Al Rajhi Bank to obtain authenticated bank documents for use in the trial, but the bank refused to produce the documents and moved to quash the subpoena,<sup>1314</sup> leading to "negative news articles," in the words of the 2010 KYC client profile prepared by HBUS for Al Rajhi Bank.<sup>1315</sup> The trial court denied the bank's motion,<sup>1316</sup> and the case was later closed as "moot."<sup>1317</sup>

One other 2010 development was action taken by an Al Rajhi related money exchange, Tahweel Al Rajhi, to join with the largest bank in Pakistan, Habib Bank Ltd., to initiate a new funds transfer product called "HBL Fast Cash." The new product was designed to allow the instant transfer of funds from Riyadh, Saudi Arabia, to any Habib branch in Pakistan, whether or not the sender or recipient of the funds had an account at either financial institution. According to one media report, Hazem Elhagrasy, the head of Tahweel Al Rajhi, said: "The new service will assure that the beneficiaries will receive payments in cash within minutes in Pakistan."<sup>1318</sup> Tariq Matin Khan, Habib Bank's general manager for financial institutions and international banking, said: "The remitters can benefit from the huge HBL network to send money to any nook or corner of Pakistan."<sup>1319</sup> The Subcommittee intended to ask Al Rajhi Bank about AML safeguards to prevent misuse of this new transfer mechanism, but the bank declined to provide any information in response to the Subcommittee's inquiry. It is unclear whether Tahweel Al Rajhi has an account at Al Rajhi Bank.

<sup>1312</sup> Id.

<sup>1313</sup> Id.

<sup>1314</sup> See Al Rajhi Banking & Investment Corp. v. Holder, Case No. 1:10-MC-00055-ESH (USDC OR 1/19/10).

<sup>1315</sup> 2010 HBUS KYC Profile of Al Rajhi Bank, at 6. See also 12/6/2011 HSBC AMLID Case

#1434 for Al Rajhi Bank, HSBC-PSI-PROD-0102340-342.

<sup>1316</sup> United States v. Sedaghaty, (USDC D OR), 2010 U.S.Dist.LEXIS 144171, Order (1/12/2010).

<sup>1317</sup> See Al Rajhi Banking & Investment Corp. v. Holder, Case No. 1:10-MC-00055-ESH, Order Dismissing Action As Moot (3/2/2010).

<sup>1318</sup> "Terror-linked Saudi bank launches major remittance program to Pakistan," Khaleej Times in Saudi Arabia (4/10/2010),

[http://www.khaleejtimes.com/biz/inside.asp?xfile=/data/business/2010/April/business\\_April183.xml&section=business&col=](http://www.khaleejtimes.com/biz/inside.asp?xfile=/data/business/2010/April/business_April183.xml&section=business&col=)

<sup>1319</sup> Id.

Meanwhile, from 2007 to 2010, HBUS continued to supply, through its London branch, hundreds of millions of U.S. dollars to Al Rajhi Bank in Saudi Arabia. In addition, at Al Rajhi Bank's request, HBUS expanded the relationship in January 2009, by authorizing its Hong Kong branch to supply Al Rajhi Bank with non-U.S. currencies, including the Thai baht, Indian rupee, and Hong Kong dollar.<sup>1320</sup> At the time, Gloria Strazza, a senior official in HBUS's Financial Intelligence Group, observed: "There was (and may be in the future) a fair amount of press and government attention focused on this entity. I am not sure we would want to engage in even this limited activity for this entity but I forward some of the intelligence from our files on this bank."<sup>1321</sup> Mr. Lok responded: "This is an on-going debate that will never go away. My stance remains the same, i.e. until it[']s proved we cannot simply rely on the Wall Street Journal[']s reports and unconfirmed allegations and 'punish' the client."<sup>1322</sup> In a later email, Mr. Lok commented: "LON [London Banknotes office] already has a relationship with Alrajhi. Adding HKG [Hong Kong Banknotes office] won't change Alrajhi's profile."<sup>1323</sup> AML compliance officer Daniel Jack offered this comment to his fellow compliance officer, Alan Williamson, regarding the account: "I believe the business owns the customer and the risk. ... I don't think you should CO [Compliance Office] deny – or even hesitate now – on this for HK [Hong Kong], despite the negative info on TF [Terrorist Financing] & Rep[utational] risk, which is not new (e.g. WSJ in Jul-07, EDD in Dec-07). I understand why Denise/Anne/Gloria are not comfortable, but I respectfully do not think it is their decision to terminate the relationship (again)."<sup>1324</sup> HBUS decided to open the Hong

<sup>1320</sup> See 2010 HBUS Hong Kong office KYC Customer Profile for Al Rajhi Bank, HSBC-PSI-PROD-0102304-306 (showing Hong Kong account for Al Rajhi Bank began trading 1/29/2009). See also 4/3/2008 email from HBME Salman Hussain to HBMD David Illing and HBEU John Scott, "Al Rajhi Bank, Saudi Arabia," OCC-PSI-00156271 (showing Al Rajhi Bank requested the Hong Kong account); 5/5/2008 exchange of emails among HBUS Christopher Lok, Gary Yeung, Stephen Allen, and others, "KYC Approval needed for: Al Rajhi Banking & Investment Corp," OCC-PSI-00155719; 6/2/2008 email from HBUS Daniel Jack to HBUS Anne Liddy, Gloria Strazza, Alan Williamson, and others, "Banknotes with Al Rajhi Banking in S.A.," OCC-PSI-00343451.

<sup>1321</sup> 6/3/2008 exchange of emails among HBUS Gloria Strazza, Daniel Jack, Christopher Lok, Stephen Allen, and others, "Banknotes with Al Rajhi Banking in S.A.," HSBC OCC 0752005-006. AML compliance officer Daniel Jack forwarded her email to Mr. Lok, Mr. Allen, and others, noting "there is still some concern in AML/ICRO regarding TF [Terrorist Financing] & reputational risk in dealing with [Al Rajhi]," and asked for an email to "address the negative info, risk analysis and appropriateness of mitigants, and your support for maintaining the HBUS relationship." Id.

<sup>1322</sup> Id.

<sup>1323</sup> 7/18/2008 email from HBUS Christopher Lok to HBUS Alan Williamson and others, "Banknotes with Al Rajhi Banking in S.A.," HSBC OCC 0760928.

<sup>1324</sup> 6/3/2008 email from HBUS Daniel Jack to HBUS Alan Williamson, "Banknotes with Al Rajhi Banking in S.A.," HSBC OCC 1638463. See also 5/30/2008 emails exchanged among HBUS Daniel Jack, Alan Williamson, and Betty NG, "KYC BankNote Profile is IB Approved for: Al Rajhi Banking & Investment," OCC-PSI-00239206; HSBC OCC 1638463.

Kong account,<sup>1325</sup> providing Al Rajhi Bank on average another \$4.6 million per month in non-U.S. currencies.<sup>1326</sup>

HBUS Banknotes finally ceased doing business with Al Rajhi Bank when, in September 2010, HSBC made a global decision to exit the U.S. banknotes business, one week after the OCC sent a lengthy Supervisory Letter to the bank criticizing its AML program, including with respect to its handling of banknotes.<sup>1327</sup>

### **I. Servicing Other Banks with Suspected Links to Terrorism**

Al Rajhi Bank was not the only bank with suspected links to terrorist financing serviced by HSBC. Two others were Islami Bank Bangladesh Ltd. and Social Islami Bank Ltd. Both banks cooperated with the Subcommittee's inquiries.

#### **(1) Islami Bank Bangladesh Ltd.**

Islami Bank Bangladesh Ltd. opened its doors in 1983, designed its operations to be in conformance with Islamic requirements, and has grown to become one of the largest private banks in Bangladesh, which is one of the most densely populated countries in the world.<sup>1328</sup> It provides a wide variety of individual and commercial banking services.<sup>1329</sup> Several of the bank's most senior officials were politically important figures within the country or in Saudi Arabia, leading to their designations as Politically Exposed Persons in the World Check database.<sup>1330</sup> According to Islami Bank Bangladesh, it has an extensive network of more than 600 correspondent accounts.<sup>1331</sup>

<sup>1325</sup> In July 2008, Mr. Williamson approved the new account and wrote to Mr. Lok, "You're in business now." 7/18/2008 email exchange between Alan Williamson, Christopher Lok, and others, "Banknotes with Al Rajhi Banking in S.A.," HSBC OCC 0761014.

<sup>1326</sup> See HBUS Hong Kong office KYC Customer Profile for Al Rajhi Bank, HSBC-PSI-PROD-0102304-306, at 2.

<sup>1327</sup> See 9/20/2010 "HSBC to Exit Asian Banknotes Business," HSBC Holdings plc Announcement, [http://www.hsbc.com/1/PA\\_esf-ca-app-content/content/assets/investor\\_relations/sea/2010/sea\\_100920\\_wholesale\\_banknotes\\_en.pdf](http://www.hsbc.com/1/PA_esf-ca-app-content/content/assets/investor_relations/sea/2010/sea_100920_wholesale_banknotes_en.pdf). See also 2010 HBUS KYC Profile on Al Rajhi Bank, at 1 (showing account deactivated on 10/14/2010); 2010 HBUS Hong Kong office KYC Profile on Al Rajhi Bank, HSBC-PSI-PROD-0102304-306, at 1 (showing Hong Kong account deactivated on 10/29/2010). In addition, in October 2010, both the OCC and Federal Reserve issued Cease and Desist Orders to HBUS and its parent holding company, HNAH, to require them to revamp their AML programs.

<sup>1328</sup> See Islami Bank Bangladesh Ltd. website, "About IBBL," <http://www.islamibankbd.com/abtIBBL/abtIBBLAtaGlance.php>; 4/19/2005 HSBC FIG report on Islami Bank Ltd.-Bangladesh, HSBC OCC 3241695; 7/4/2012 email from Islami Bank Bangladesh Ltd. to Subcommittee, PSI-IBBL-01-0001.

<sup>1329</sup> See Islami Bank Bangladesh Ltd. website, "Products & Services,"

<http://www.islamibankbd.com/prodServices/prodServices.php>

<sup>1330</sup> See 4/19/2005 HSBC FIG report on Islami Bank Ltd.-Bangladesh, at HSBC OCC 3241696; 5/11/2006 FIG report on Islami Bank Bangladesh, HSBC OCC 3241693.

<sup>1331</sup> 7/4/2012 email from Islami Bank Bangladesh Ltd. to Subcommittee, PSI-IBBL-01-0001.

Islami Bank Bangladesh applied to open accounts with HSBC in 2000, and currently has correspondent accounts with HSBC in 24 locations around the world.<sup>1332</sup> According to the bank, it opened a U.S. dollar account with HBUS in 2000, and U.S. dollar clearing accounts with HSBC India and HSBC Pakistan in 2006. In 2007, the HBUS branch in Singapore also sought approval to open an account for the bank to supply it with physical U.S. dollars, cash U.S. dollar monetary instruments such as travelers cheques and money orders, process U.S. dollar wire transfers, and provide other services.<sup>1333</sup>

**Opening 2007 HBUS Account.** Documents show that proposals to open the 2007 HBUS account for Islami Bank immediately raised AML concerns within HBUS AML Compliance, not only because the bank was located in a country ranked by HSBC as at “high risk” of money laundering<sup>1334</sup> and ranked by Transparency International as one of the most corrupt country in the world,<sup>1335</sup> but also because members of the Al Rajhi group held a 37% direct ownership interest in the bank.

In the fall of 2007, Kwok Ying Fung at the HBUS office in Singapore asked Beth Fisher at HBUS AML Compliance to approve Islami Bank’s KYC profile, but she declined without explaining why.<sup>1336</sup> On October 24, 2007, after receiving her response, he asked HBUS AML Compliance to suggest someone else to approve opening the account.<sup>1337</sup> Angela Cassell-Bush suggested that he “reach out to Chris Lok to see if he is willing to be the RM [Relationship Manager] Approver.”<sup>1338</sup> Ms. Fisher warned her colleagues that, given the connection between the Bangladeshi bank and Al Rajhi Bank, “[t]his is not just an RM issue. This is a KYC due diligence issue.”<sup>1339</sup>

On November 6, 2007, Mr. Fung asked Mr. Lok, head of HSBC Global Banknotes and located in HBUS offices in New York, if he would consider serving as the “RM [Relationship Manager] approver” of the Islami Bank KYC profile, so that the bank could become a “shared

<sup>1332</sup> See HBUS Know Your Customer Profile of Islami Bank Bangladesh Ltd. (3/9/2012), HSBC-PSI-PROD-0117222-237 (hereinafter “2012 HBUS KYC Profile of Islami Bank”), at 2; 7/4/2012 email from Islami Bank Bangladesh Ltd. to Subcommittee, PSI-IBBL-01-0001.

<sup>1333</sup> See 2012 HBUS KYC Profile of Islami Bank at 2.

<sup>1334</sup> Id. at 1.

<sup>1335</sup> See 2007 “Corruption Perceptions Index,” Transparency International, [http://archive.transparency.org/policy\\_research/surveys\\_indices/cpi/2007](http://archive.transparency.org/policy_research/surveys_indices/cpi/2007) (ranking Bangladesh as 162 out of 180 countries in terms of perceived levels of corruption).

<sup>1336</sup> See 10/24/2007 email from HBUS Kwok Ying Fung to HBUS Jarrett Payne and Angela Cassell-Bush, “KYC BankNotes Profile is IB Denied for: Islami Bank Bangladesh Limited,” HSBC OCC 0739990-991.

<sup>1337</sup> Id.

<sup>1338</sup> 11/6/2007 email from Angela Cassell-Bush to Kwok Ying Fung with copies to Beth Fisher and others, “KYC BankNotes Profile is IB Denied for: Islami Bank Bangladesh Limited,” HSBC OCC 0739990.

<sup>1339</sup> 11/7/2007 email from HBUS Beth Fisher to HBUS Angela Cassell-Bush and others, “KYC BankNotes Profile is IB Denied for: Islami Bank Bangladesh Limited,” HSBC OCC 0739989.

client” of HBUS Banknotes and HBUS Payments and Cash Management (PCM).<sup>1340</sup> On November 8, 2007, Mr. Lok responded that his interest in considering a new account depended upon whether there was enough potential revenue to make the effort of vetting Al Rajhi worth it:

“First, I’m happy to be the RM [Relationship Manager] if this is an account worth chasing. How much money can you expect to make from this name? If this can be answered positively then I will ask PCM to check out the ... alrajhi connection. ... The name Alrajh has been a name heatedly debated for many years. We terminated our trading relationship following 911 and only a year ago after London Compliance came back telling NYK the group is happy to let us resurrect the relationship that we went back. ... Not saying just because of this connection we won’t do business. It[’]s just that if the revenue is there then we’re prepared for a good fight.”<sup>1341</sup>

Mr. Lok’s email suggests that he expected from the outset that HBUS AML Compliance would resist opening an account for Islami Bank and it would take a “fight” to open the account.

Later the same day, Benjamin Saram of HBUS Singapore emailed Mr. Lok and others with information about the likely revenues if an account were opened for Islami Bank. He wrote that, because approximately 60,000 Bangladeshis traveled to Saudi Arabia each year on religious pilgrimages and would require about \$1,000 to \$3,000 each, “we’re therefore looking at about USD 60 mio [million] of currency needs on an annual basis.”<sup>1342</sup> He noted that, in 2006, HBUS Banknotes had netted about \$47,000 in profits in Bangladesh, and expected a 53% increase in 2007, to about \$75,000, explaining, “[w]e are a monopoly here, and margins are decent.”<sup>1343</sup> Mr. Saram estimated that, if an account were opened for Islami Bank, the “net profit would be approximately USD 75,000/ year.”

Mr. Lok responded: “One, the money is there and we should go for this account. Two, I will jump in and wear the GRM [Global Relationship Manager] hat. ... I believe we should be able to get the K[YC] sign off.”<sup>1344</sup> He also asked HBUS AML Compliance to look into the possible connection between Islami Bank and Al Rajhi Bank.

<sup>1340</sup> 11/6/2007 email from HBUS Kwok Ying Fung to HBUS Christopher Lok, “Islami Bank Bangladesh Limited,” HSBC OCC 0739989.

<sup>1341</sup> 11/8/2007 email from HBUS Christopher Lok to HBUS Kwok Ying Fung and others, “Islami Bank Bangladesh Limited,” HSBC OCC 0739988-989.

<sup>1342</sup> 11/8/2007 email from HBUS Benjamin Saram to HBUS Christopher Lok, Kwok Ying Fung, and others, “Islami Bank Bangladesh Limited,” HSBC OCC 0739987-988.

<sup>1343</sup> Id.

<sup>1344</sup> 11/8/2007 email from HBUS Christopher Lok to HBUS Benjamin Saram, Kwok Ying Fung, and others, “Islami Bank Bangladesh Limited,” HSBC OCC 0739987.

The next day, November 9, 2007, HBUS AML compliance officer Angela Cassell-Bush confirmed a direct link between the two banks:

“[P]lease note that there is a connection between ISLAMI BANK BANGLADESH LIMITED-Bangladesh and Al-Rajhi Bank .... Based on the information we have on file, the Al - Rajhi family has been associated with Islami Bank Bangladesh Limited, since its inception. They have at least 37% direct ownership ... through their ownership within the following companies: Arabsas Travel & Tourist Agency, 9.999%; Janab Yousif Abdullah Abdul Aziz Al-Rajhi, 9.936%; Al-Rajhi Company for Industry & Trade, 9.94%; Abdullah Abdul Aziz Al-Rajhi, 7.58%. This same family has major controlling interest within Al-Rajhi bank.”<sup>1345</sup>

**Troubling Information.** HBUS’ Singapore branch actually opened the account for Islami Bank in December 2007.<sup>1346</sup> Mr. Lok and others approved the account, despite ongoing questions about its primary shareholder, Al Rajhi Bank, whose past links to terrorist financing had received additional attention in the media during the summer of 2007. HBUS also approved the account despite troubling information about Islami Bank itself.

The troubling information about Islami Bank was contained in an internal report that had been prepared less than a year earlier by HSBC’s Financial Intelligence Group (FIG).<sup>1347</sup> The May 2006 FIG report disclosed that, in March 2006, “Abdur Rahman, chief of the Jamaatul Mujahideen of Bangladesh (JMB), and his second-in-command, Bangla Bhai, were arrested for being responsible for the terrorist bomb blasts of August 17, 2005 in Bangladesh.”<sup>1348</sup> The FIG report noted that Mr. Rahman had been found to have an account at Islami Bank.<sup>1349</sup>

<sup>1345</sup> 11/9/2007 email from HBUS Angela Cassell-Bush to HBUS Christopher Lok and others, “Islami Bank Bangladesh Limited-Bangladesh,” OCC-PSI-00154139, at 1. Mr. Lok asked Ms. Cassell-Bush to doublecheck one of the shareholders, Abdullah Abdul Aziz Al-Rajhi, who was listed as holding 7.58% of the shares, suggesting that the wrong company may have been identified as the shareholder. A later email suggested that the shareholding company was not a member of the Al Rajhi group. See November and December 2007 exchange of emails among HBUS Christopher Lok, Angela Cassell-Bush, Muhammad Shohiduzzaman, and others, “Islami Bank Bangladesh Limited-Bangladesh,” HSBC OCC 0741466-469. Later KYC profiles for the bank indicate, however, that the shares were, in fact, held through a company that was part of the Al Rajhi group. See, e.g., 2012 HBUS KYC Profile of Islami Bank, at 7. Islami Bank Bangladesh Ltd. has confirmed to the Subcommittee that Abdullah Abdul Aziz Al Rajhi has been both a shareholder and director of the bank. 7/4/2012 email from Islami Bank Bangladesh Ltd. to Subcommittee, PSI-IBBL-01-0001.

<sup>1346</sup> See 2012 HBUS KYC Profile of Islami Bank, at 15.

<sup>1347</sup> See 5/11/2006 FIG report on Islami Bank Bangladesh, HSBC OCC 3241692-694.

<sup>1348</sup> Id. at 693.

<sup>1349</sup> Id. Islami Bank Bangladesh Ltd. told the Subcommittee, however, that it has never had an account for Abdur Rahman. 7/4/2012 email from Islami Bank Bangladesh Ltd. to Subcommittee, PSI-IBBL-01-0001.

The FIG report also disclosed that an investigation by the Central Bank of Bangladesh found that two branches of Islami Bank had been engaged in “suspicious transactions” and urged the bank to take action against 20 bank employees, including for failing to report the suspicious transactions.<sup>1350</sup> According to the FIG report, in response, Islami Bank reportedly suspended five officers and warned 15 others.<sup>1351</sup> The FIG report stated that Bangladeshi news articles had observed it was the third time Islami Bank had been fined by the Central Bank “for covering up militants’ transactions.”<sup>1352</sup>

Islami Bank’s KYC profile repeated this information and indicated that the HSBC Global Relationship Manager had visited the bank to ask about the matter, and was told that the incident did not involve terrorist financing.<sup>1353</sup> The Global Relationship Manager advised against taking any further action, attributing the AML failures to the bank’s unsophisticated technology platform.<sup>1354</sup> Neither the KYC profile nor the FIG report indicate whether any steps were taken to verify the bank’s explanation of the incident with the Central Bank. The KYC profile noted that, in 2006, FIG recommended classifying Islami Bank as a “Special Category Client,” or SCC, HSBC’s designation for its highest risk clients, but that recommendation was rejected, which meant HSBC did not subject the bank to any enhanced monitoring.<sup>1355</sup>

**2009 Information on IIRO Accounts.** The HBUS account was opened near the end of 2007. About 18 months later, in May 2009, a FIG due diligence report prepared for another Bangladeshi bank with which HBUS did business, Social Islami Bank, discussed below, disclosed new information relevant to Islami Bank. This information related to the International Islamic Relief Organization (IIRO), a Saudi nonprofit organization which, in 2006, had two of its branches and a high ranking IIRO official designated by the United States as terrorist financiers and added to the list of entities with which U.S. persons are prohibited from doing business.<sup>1356</sup>

<sup>1350</sup> 5/11/2006 FIG report on Islami Bank Bangladesh, at HSBC OCC 3241693.

<sup>1351</sup> Islami Bank Bangladesh told the Subcommittee that it suspended and later fired the bank officials involved. 7/4/2012 email from Islami Bank Bangladesh Ltd. to Subcommittee, PSI-IBBL-01-0001.

<sup>1352</sup> 5/11/2006 FIG report on Islami Bank Bangladesh, at HSBC OCC 3241693.

<sup>1353</sup> 2012 HBUS KYC Profile of Islami Bank, at 3.

<sup>1354</sup> Id. (The Global Relationship Manager wrote: “[C]onsidering that Islami Bank is involved in mass banking with a pretty large branch network without a sophisticated or integrated IT platform, there will always be a chance that isolated incidents like this might be found. As such, we will closely monitor the future events and keep you informed as soon as any issue of concern is detected.”).

<sup>1355</sup> Id.

<sup>1356</sup> See 8/3/2006 “Treasury Designates Director, Branches of Charity Bankrolling Al Qaida Network,” U.S. Treasury Department press release, reprinted in 8/2/2006 email from HBUS Sharyn Malone to HBUS Stephanie Napier and others, “Social Investment Bank, Bangladesh,” HSBC OCC 3259936.

The 2009 FIG report stated that the IIRO had accounts at both Social Islami Bank and Islami Bank.<sup>1357</sup> It quoted a 2008 local press article saying that, in response to the action taken by the United States in 2006, Islami Bank had frozen its IIRO accounts.<sup>1358</sup> The FIG report did not indicate when the accounts were first opened, what actions had been taken beyond freezing them, or how much money was involved. In 2010, an HBUS KYC profile for Social Islami Bank referenced a letter from the Bangladeshi Central Bank, dated June 30, 2010, indicating that IIRO had accounts at three Bangladeshi banks, including Islami Bank, which needed to be closed.<sup>1359</sup>

Islami Bank Bangladesh confirmed to the Subcommittee that IIRO had two accounts at the bank which opened in 1993 and 1994, when IIRO was a nongovernmental organization in good standing.<sup>1360</sup> It stated that after the IIRO was added to a United Nations sanctions list in 2006, it froze the accounts and reported them to the Bangladeshi Central Bank. In 2010, according to the bank, it received an “instruction from the Central Bank at the direction of [the] Ministry of Finance” to unfreeze the accounts and “transfer the accounts” to a government owned bank, BASIC Bank, which it did.<sup>1361</sup>

Despite the 2008 published article, the information in the two internal HBUS documents related to Social Islami Bank, and Islami Bank Bangladesh’s willingness to discuss the accounts, no information about the IIRO accounts appeared in the HBUS KYC profile for Islami Bank. While the IIRO accounts at Social Islami Bank were the focus of extensive discussions in emails and other documents by HBUS AML Compliance personnel and HBUS bankers working in Bangladesh, no similar discussions appear in any of the HBUS documents related to Islami Bank.

In September 2009, the Islami Bank KYC profile indicates that an unnamed HSBC employee requested a new enhanced due diligence report on the bank.<sup>1362</sup> HBUS Compliance denied the request, indicating an update “is NOT needed at this time.”<sup>1363</sup>

**2010 SCC Designation.** In February 2010, HBUS AML Compliance personnel reviewed the Islami Bank account and

<sup>1357</sup> See 5/5/2009 FIG Report of Findings on Social Investment Bank Limited, OCC-PSI-00823818, at 7 (quoting 10/8/2008 article from Bangladeshnews.com).

<sup>1358</sup> Id.

<sup>1359</sup> 2012 HBUS KYC Profile of Social Islami Bank, at 4 (“The 3 bank accounts of IIRO namely i) Social Islami Bank Ltd. ii) Islami Bank Bangladesh Ltd. iii) Al-Falah Islami Bank Ltd. must be disposed off [sic] and transferred”).

<sup>1360</sup> 7/4/2012 email from Islami Bank Bangladesh Ltd. to Subcommittee, PSI-IBBL-01-0001-003, at 003.

<sup>1361</sup> Id.

<sup>1362</sup> 2012 HBUS KYC Profile of Islami Bank, at 2.

<sup>1363</sup> Id.



recommended that the bank be designated an SCC client.<sup>1364</sup> One key reason given for the proposed SCC designation was Islami Bank's links to the Al Rajhi group, noting that the Vice Chairman of the bank and 10% owner was Yousif Abdullah Al Rajhi, that Al Rajhi interests held about a third of the bank's shares, and Al Rajhi itself had links to terrorist financing.<sup>1365</sup> Another reason given was the information provided in the 2006 FIG report, that the Bangladeshi Central Bank had issued a "notice of cause" to Islami Bank "to explain accounts owned by suspected Islamic Militants," and reportedly fined the bank for the third time "for covering up militants[]" transactions."<sup>1366</sup> No mention was made of the IIRO accounts. Contrary to the outcome in 2006, in 2010, HSBC designated Islami Bank as an SCC client.<sup>1367</sup>

Later in 2010, an OCC AML examiner reviewing emails related to Islami Bank characterized the information provided about the bank as depicting "extreme circumstances," and recommended that the account be reviewed as part of a larger AML "look back" effort at HSBC.<sup>1368</sup> In 2011, HSBC engaged in an extensive discussion with Islami Bank regarding its AML policies and procedures, also noting in its KYC profile that the bank acted as a "payout agent" for 53 money exchange businesses across the Middle East.<sup>1369</sup>

Today, although HSBC exited the U.S. banknotes business in 2010, Islami Bank Bangladesh remains a customer of two dozen HSBC affiliates, including HBUS PCM, which continues to provide Islami Bank with access to U.S. dollars, U.S. wire transfers, and U.S. payment systems.<sup>1370</sup>

## (2) Social Islami Bank Ltd.

A third bank serviced by HSBC despite suspected links to terrorist financing is Social Islami Bank Ltd.

Social Islami Bank Ltd. was founded in 1995, changed its name from Social Investment Bank Ltd. in 2009, and is located in Bangladesh.<sup>1371</sup> It operates 76 branches throughout the country and provides a variety of individual and commercial banking services, including deposits, loans, investment advice, commercial financing, foreign exchange, and wire transfers. It operates in conformance with

<sup>1364</sup> See 2/3/2010 email exchange between HBUS Jon K. Jones, Ali Kazmy and others, "Islami Bank Bangladesh Ltd – Poss SCC," OCC-PSI-00453499.

<sup>1365</sup> Id.

<sup>1366</sup> Id.

<sup>1367</sup> Id. See also 2012 HBUS KYC Profile of Islami Bank, at 3.

<sup>1368</sup> 10/27/2010 email from OCC AML Examiner Joseph Boss to OCC colleagues, OCC-PSI-00919631.

<sup>1369</sup> 2012 HBUS KYC Profile of Islami Bank, at 3-4.

<sup>1370</sup> 2012 HBUS KYC Profile of Islami Bank, at 2, 7.

<sup>1371</sup> See Social Islami Bank website, <http://www.sibld.com/html/homepages.php>; HBUS "Know Your Customer Profile" of Social Islami Bank Ltd. (2/7/2012), HSBC-PSI-PROD-0102782-789 (hereinafter "2012 HBUS KYC Profile of Social Islami Bank"), at 2.

Islamic requirements and is publicly traded on Bangladeshi stock exchanges. Its headquarters are in Dhaka, the capital of Bangladesh, one of the world's largest cities with a population of 16 million.

Until May 2012, HSBC was one of the bank's major correspondents, providing it with services in multiple countries.<sup>1372</sup> HSBC also has an affiliate located in Dhaka. That affiliate, HSBC Bank Asia Pacific (HBAP) Dhaka, introduced Social Islami Bank to HBUS.<sup>1373</sup> In 2003, HBUS Payments and Cash Management (PCM) sought to open an account for Social Islami Bank, providing it with U.S. dollar wire transfer and clearing services.<sup>1374</sup>

**Opening of HBUS Account.** When HBUS first sought to open the account in 2003, it asked for an enhanced due diligence report on the bank from the HSBC Financial Intelligence Group (FIG). In addition to noting that Bangladesh was a high risk country due to its reputation for corruption, the resulting FIG report contained adverse information about some of the bank's owners and officials.<sup>1375</sup> Most serious were allegations that two shareholders, the International Islamic Relief Organization (IIRO) and the Islamic Charitable Society Lajnat al-Birr Al Islam (Lajnat al-Birr), had links to terrorism. IIRO then held 8.62% of the total outstanding shares, and was the bank's largest single shareholder, while Lajnat al-Birr held 1.54%.

The 2003 FIG report stated the following with regard to the two shareholders:

"IIRO is a Saudi-Arabian charity. ... The IIRO was named in the 2002 lawsuit brought forward on behalf of family members of victims of the September 11, 2001 terrorist attacks. The IIRO was accused of having 'played key roles in laundering of funds to terrorist[s] for the 1998 African embassy bombings' and having been involved in the 'financing and aiding and abetting of terrorists in the 1993 World Trade Center bombing.' The IIRO has also reportedly funded al-Qaeda directly as well as several of its satellite groups. Osama bin Laden's brother-in-law, Mohammed Jamal Khalifa, headed the Philippine branch of the IIRO in the 1990's. The Philippine government has charged that the group contributed to terrorist causes there."<sup>1376</sup> ...

<sup>1372</sup> See Social Islami Bank website, "List of Correspondents/Agency Arrangements Overseas," <http://www.sibibd.com/download/CorrespondentsAgencyArrangementsOverseas.pdf>.

<sup>1373</sup> 2012 HBUS KYC Profile of Social Islami Bank, at 7.

<sup>1374</sup> Id. at 2, 14.

<sup>1375</sup> See 11/2003 Report on Findings for Social Investment Bank, Ltd., HSBC Financial Intelligence Group, OCC-PSI-00823818, at 18 (hereinafter "2003 FIG Report on Social Islami Bank").

<sup>1376</sup> Id. at 1-2.

Lajnat al-Birr Al Islamiyah was established in 1987. It has been stated that Lajnat al-Birr Al Islamiyah was the original name of the Benevolence International [F]oundation, and that it originally had offices in Saudi Arabia and Pakistan. According [to] the U.S. government, among the purposes of Lajnat was to ‘raise funds in Saudi Arabia to provide support to the Mujahadeen then fighting in Afghanistan,’ as well as to provide ‘cover for fighters to travel in and out of Pakistan and obtain immigration status.’ Benevolence International has been tied to terrorism and its director, Enaam Arnaout, was indicted in 2002 with conspiring to defraud his group’s donors by secretly providing financial and logistical help to al-Qaeda for a decade.”<sup>1377</sup>

The FIG report also contained negative information about the bank’s founder:

“Dr. M.A. Mannan was the chairman and founder of Social Investment Bank Ltd. He was fired in 2000 after fault was found with his banking procedure. It was alleged that he created an obstacle to the team of Bangladesh Bank [Bangladesh’s Central Bank] during their visit to Social Investment Bank Ltd. Additionally, he was accused of interfering with bank administrative work and with harassing a bank employee.”<sup>1378</sup>

The FIG report concluded:

“In conclusion, it is of significant concern that the leading shareholder of Social Investment Bank Ltd. (at 8.62%), International Islamic Relief Organization, has been accused in both the Philippines and in America of funding terrorist groups. The group is currently under investigation by the F.B.I. Another of the bank’s shareholders, Lajnat al-Birr Al Islam (at 1.54%) has also been connected to terrorist groups. Additionally, the bank’s founder and chairman was let go on allegations of interference and harassment. ... Finally, it is important to note that Social Investment Bank Ltd. is located in Bangladesh, which was ranked as the world’s most corrupt nation by Transparency International.”<sup>1379</sup>

The FIG report offered this cautious analysis about whether to open an account:

“Although the allegations presented in this report, primarily against the International Islamic Relief Organization (IIRO) and

<sup>1377</sup> Id. at 2.

<sup>1378</sup> Id. at 3.

<sup>1379</sup> Id. at 4.

the Lajnat al-Birr Al Islamiyah, are highly adverse, no U.S. or foreign government law enforcement or regulatory body has stated unconditionally, that these organizations are under sanction. The reputational risk is significant, however, and the possibility that further investigations by U.S. authorities may ultimately uncover substantiating proof of a connection to terrorism. The risk of future sanctions and the reputational risk based on allegations noted in this report should be measured against the current risks involved in our relationship when ultimately deciding a course of action.”<sup>1380</sup>

While the 2003 FIG report provided significant adverse information about Social Islami Bank and noted that Lajnat al-Birr was the original name of the Benevolence International Foundation which “had been tied to terrorism,” it failed to state that, in 2002, the United States had designated the Benevolence International Foundation as a “financier of terrorism” with whom U.S. persons are prohibited from doing business.<sup>1381</sup> This additional terrorism-related designation meant that when HBUS was considering whether to open an account for Social Islami Bank in 2003, Social Islami Bank was partially owned by two organizations associated with terrorist financing.<sup>1382</sup>

Despite its failure to provide that additional information, the 2003 FIG report provided significant negative information about Social Islami Bank and squarely raised the question of whether HBUS should be doing business with it, given the “highly adverse” allegations. Nevertheless, on October 14, 2003, HBUS AML Compliance approved Social Islami Bank as an HBUS PCM client.<sup>1383</sup> In addition, despite the bank’s location in a high risk country, the terrorist links uncovered in connection with two of its shareholders and a director, HBUS opened the account without designating the bank as an SCC client warranting additional monitoring and due diligence reviews. HBUS immediately began providing the bank with services that included clearing U.S. dollar

<sup>1380</sup> Id. at 1.

<sup>1381</sup> “Treasury Designates Benevolence International Foundation and Related Entities as Financiers of Terrorism,” U.S. Treasury Department press release No. PO-3632 (11/19/2002), [www.treasury.gov/press-center/press-releases/Pages/po3632.aspx](http://www.treasury.gov/press-center/press-releases/Pages/po3632.aspx). See also Executive Order 13224, “Blocking Property and Prohibiting Transactions with Persons who Commit, Threaten to Commit, or support Terrorism” (9/23/2001).

<sup>1382</sup> The 2003 FIG Report also failed to mention that Social Islami Bank had opened an account for Al Rajhi Commercial Foreign Exchange. That money exchange business was part of the Al Rajhi Group, whose U.S. business and charitable ventures were the subject of a 2002 law enforcement search to disrupt terrorist financing. The FIG may have been unaware of the account at that time, although a 2005 FIG report on Al Rajhi Commercial Foreign Exchange disclosed it. See 7/13/2005 HBUS Financial Intelligence Group (FIG) Report of Findings (Update) on Al Rajhi Commercial Foreign Exchange, HSBC OCC 2725167-168. In 2005, Al Rajhi Commercial Foreign Exchange and seven other businesses merged into Al Bilad Bank. Id. According to bank counsel, the Al Rajhi Commercial Foreign Exchange account closed in July 2002. Subcommittee briefing by HSBC legal counsel (6/27/2012).

<sup>1383</sup> 2012 HBUS KYC Profile of Social Islami Bank, at 14.

monetary instruments and U.S. wire transfers. Those services produced revenues from Social Islami Bank totaling about \$100,000 per year.<sup>1384</sup>

**2005 Review.** Two years after the account was opened, as part of a broader HSBC effort to update its KYC client profiles in 2005, Social Islami Bank was the subject of a second enhanced due diligence review.<sup>1385</sup> The resulting 2005 FIG report again identified IIRO, the bank's largest shareholder, as linked to terrorism, noting that it was "alleged to have provided funding to terrorist groups such as Al Qaeda in the past," and is "alleged to have acted as a cover for Al-Qaeda operations in the Philippines."<sup>1386</sup> The FIG report stated: "Based on the frequency with which the group is connected to terrorist financing in the press, it is likely that their activities will always be under scrutiny, and future government sanctions against the group are highly probable."<sup>1387</sup> The report also noted that Social Islami Bank did "not appear to have correspondent relationships with many of the other major global banking corporations."<sup>1388</sup> The FIG report "strongly recommend[ed]" that the account not be approved "until the matter is discussed with Senior Compliance Management."<sup>1389</sup>

Despite the concerns raised in the FIG report, HBUS retained Social Islami Bank as a client. At the same time, to address concerns about the account, HBUS AML Compliance required the HSBC CEO for Bangladesh to provide annual approval of the account for it to stay open.<sup>1390</sup> Despite this requirement, the Subcommittee uncovered only one instance in which approval was granted, and when asked, HSBC was unable to provide any additional documentation.<sup>1391</sup>

**2006 Terrorist Designation.** Eighteen months later, on August 3, 2006, the United States designated two branches of IIRO and a high ranking IIRO official as terrorist financiers and prohibited U.S. persons

<sup>1384</sup> Id. at 8.

<sup>1385</sup> See 3/8/2005 email from HBUS Nanayo Ryan to HBUS FIG Michael Ellis, "Social Investment Bank Ltd Bangladesh," HSBC-PSI-PROD-0102769-770.

<sup>1386</sup> 3/10/2005 "Report of Findings – Social Investment Bank Ltd. – FIG (UPDATE)," HBUS Financial Intelligence Group, OCC-PSI-00823818 (hereinafter "2005 FIG Report on Social Islami Bank"), at 15.

<sup>1387</sup> Id.

<sup>1388</sup> Id.

<sup>1389</sup> Id.

<sup>1390</sup> HBUS AML head Terri Pesce told the Subcommittee it was "unusual" to obtain CEO approval of an account. Subcommittee interview of Teresa Pesce (3/30/2012). See, e.g., 2012 HBUS KYC Profile of Islami Bank, at 14-15; 2/9/2010 email from HBUS Jon K. Jones to HBAP Sadique Reza and others, "Compliance Conditions: Social Islami Bank Ltd," HSBC-PSI-PROD-0102645.

<sup>1391</sup> This approval was provided in April 2005 by Steve Banner, HSBC Bangladesh CEO. He wrote with regard to Social Investment Bank: "I have been in Bangladesh for only 2 months and have not yet met any of the executives from SIBL. Based on my discussion with Shohid, however, I can see no reason why we should not continue the relationship as at present." 4/16/2005 email from HSBC Steve Banner, HSBC PSI PROD 0102765. See also Subcommittee briefing by HSBC legal counsel (4/12/2012).

from transacting business with them.<sup>1392</sup> Treasury Under Secretary for Terrorism and Financial Intelligence Stuart Levey said: "We have long been concerned about these IIRO offices; we are now taking public action to sever this link in the al Qaida network's funding chain."<sup>1393</sup>

In response, on the same day, HBUS AML Compliance placed a block on the Social Islami Bank account, so that no funds could be withdrawn. The email imposing the block noted that the Social Islami Bank brought in HBUS revenues totaling \$44,000 per year.<sup>1394</sup>

The next day, August 4, 2006, the HSBC Financial Intelligence Group (FIG) issued an updated due diligence report on Social Islami Bank, containing significant adverse information about IIRO.<sup>1395</sup> Among other information, the FIG report noted that the World Check database relied on by HSBC for KYC information classified IIRO as associated with terrorism, linked it to providing assistance to al Qaeda and other terrorist organizations, and described it as "allegedly linked" to the 1993 World Trade Center bombing, "plots to assassinate Bill Clinton and the Pope," and "the planned destruction of the Lincoln Tunnel and Brooklyn Bridge."<sup>1396</sup>

Two days after that, on August 6, 2006, an HSBC institutional banker from HBAP Dhaka, Muhammad Shohiduzzaman, met with Social Islami Bank to discuss IIRO.<sup>1397</sup> He wrote to the HSBC CEO in charge of the operations in Bangladesh, Steven Banner, that Social Islami Bank had told him that IIRO "never took part in any activities" at the bank, "did not even take possession of the shares," and had never been a board member.<sup>1398</sup> Mr. Shohiduzzaman advised: "we are of the opinion that since IIRO is not involved in the operation of SIBL [Social Islami Bank Ltd.], there [are] no issues of concern locally. But since the matter has been raised by the US treasury, HBUS should take appropriate measure after careful examination of all the present and potential aspects."<sup>1399</sup> Mr. Banner wrote to Hersel Mehani, the HSBC sales person assigned to the account: "Based on the feedback from

<sup>1392</sup> See 8/3/2006 press release, "Treasury Designates Director, Branches of Charity Bankrolling Al Qaida Network," U.S. Treasury Department, reprinted in 8/3/2006 email from HBUS Sharyn Malone to HBUS Stephanie Napier and others, "Social Investment Bank, Bangladesh," HSBC OCC 3259936.

<sup>1393</sup> 8/3/2006 press release, "Treasury Designates Director, Branches of Charity Bankrolling Al Qaida Network," U.S. Treasury Department, reprinted at HSBC OCC 3259936.

<sup>1394</sup> 8/3/2006 email from HBUS Sharyn Malone to HBUS colleagues, HSBC-PSI-PROD-0102776 ("IIRO holds a 8.62% stake in Social Investment Bank (SIB), Bangladesh who is a US PCM client of HBUS since Oct. 2003. Their value to US PCM is \$44K annualized.").

<sup>1395</sup> See 8/4/2006 FIG Report of Findings (Update) on Social Investment Bank Limited, OCC-PSI-00823818, at 12.

<sup>1396</sup> Id. at 3.

<sup>1397</sup> 8/6/2006 email from HBAP Muhammad Shohiduzzaman to HBAP Steve Banner, "Social Invst Bank Bangladesh," HSBC OCC 3260411-412.

<sup>1398</sup> Id.

<sup>1399</sup> Id.

SIBL, IIRO's role remains that of a minority shareholder that does not seek to engage in the management of the bank. We have no reason to disbelieve SIBL's statements. There are therefore no grounds for me to recommend an account closure or account freeze."<sup>1400</sup>

Mr. Banner continued:

"I appreciate, however, that HBUS may feel compelled to act firmly in the light of OFAC's position. This is obviously a decision that rests with HBUS and I can confirm that we will not object to such action. That said, we would much prefer it if SIBL is allowed to withdraw the balances held with HBUS before you freeze or close the account. From our perspective there appears to be no justification for depriving SIBL of their funds and to do so would open HSBC to unwanted reputational damage / regulatory scrutiny locally."<sup>1401</sup>

In essence, Mr. Banner asked for the account to be kept open but if it were frozen, to allow Social Islami Bank to pull its money first so that none of its funds would be affected.

Later that same day, August 6, 2006, HBUS AML Compliance officer Alan Ketley forwarded the email exchange to his AML Compliance colleagues, George Tsugranes and Andrew Rizkalla, and asked for their thoughts.<sup>1402</sup> Both advised closing the account. Mr. Tsugranes wrote:

"Although the Philippine and Indonesia branch offices were cited, the Treasury action also cited Abd Al Hamid Sulaiman Al-Mujil who is a high ranking IIRO official. So although only the 2 branches were cited, having a top official in the organization mentioned should be cause for concern involving the IIRO. As this organization has a 9.0% stake and does not involve itself on the day to day operations or mgmt – who is to say that they won't sooner or later or start moving funds through this acct."<sup>1403</sup>

Mr. Rizkalla wrote:

"I remain firm to my first opinion, the account should be closed in an orderly fashion. We still don't know if there is a nominee shareholder interest to IIRO, the U.S. Govt has designated IIRO

<sup>1400</sup> 8/6/2006 email from HBAP Steve Banner to HBAP Muhammad Shohiduzzaman, "Social Invest Bank Bangladesh," HSBC OCC 3260411.

<sup>1401</sup> Id. See also 8/6/2006 email from HBAP Hersel Mehani to HBUS Alan Ketley, HSBC OCC 3260410.

<sup>1402</sup> 8/7/2006 email exchange among HBUS Alan Ketley, George Tsugranes, and Andrew Rizkalla, "Social Invest Bank Bangladesh," HSBC OCC 3260409-410.

<sup>1403</sup> Id.

for supporting terrorism, so even the small shareholder ownership entitles them to profits and dividends from Soc Invst Bank to reinvest where??. .... Hersel says monitor the accounts for 6 months, will he be doing the monitoring??”<sup>1404</sup>

Despite their advice to close the account, Mr. Ketley lifted the block on the account four days after it was imposed and approved keeping the account open:

“After reviewing the information provided by HSBC Dhaka my provisional decision is that this relationship be allowed to continue. It will need to be designated as an SCC Category 4 (reputational risk) with immediate effect and will be subject to closer monitoring as a result .... I am not willing to commit to the 6 months suggested by Hersel and we will review activity and determine what further action may be required as events warrant. ... IIRO’s shareholding is a minority holding and information received indicates that they exert neither management control nor have board representation. While this entity clearly represents a heightened reputational risk to the bank, I believe that with the knowledge we have today and the controls that are being implemented we have mitigated that risk adequately.”<sup>1405</sup>

A few days later, FIG forwarded its report on Social Islami Bank to the head of HBUS AML Compliance, Teresa Pesce. She wrote to Mr. Ketley: “This makes me very uncomfortable. Can we talk to the business about this?”<sup>1406</sup> Despite the discomfort she expressed and the advice of two AML compliance officers, the account was kept open. Mr. Ketley reported to the Subcommittee that he understood that IIRO was a passive shareholder, that Social Islami was attempting to expel them, and that he talked about the account with Terri Pesce and Denise Reilly and believed they supported his decision to maintain the account.<sup>1407</sup> Ms. Pesce told the Subcommittee that she did not recall much about the relationship, but the bank should have reached out to OFAC with regard to it.<sup>1408</sup> HBUS OFAC Compliance officer Elizabeth Protomasto told the Subcommittee that she contacted OFAC about this relationship after the SDN designation, and was told that the bank could continue to do business with Social Islami Bank, because only two branches of the IIRO had been designated by OFAC as SDNs, not all

<sup>1404</sup> Id.

<sup>1405</sup> 8/7/2006 email from HBUS Alan Ketley to Hersel Mehani and others, “Social Investment Bank,” HSBC OCC 3260426.

<sup>1406</sup> 8/11/2006 email from HBUS Teresa Pesce to Alan Ketley and Andrew Rizkalla, “Re: Report of Findings – Social Investment Bank Limited – Bangladesh – FIG,” HSBC OCC 3261519.

<sup>1407</sup> Subcommittee interview of Alan Ketley (2/16/2012).

<sup>1408</sup> Subcommittee interview of Teresa Pesce (3/30/2012).



branches and not the branch in Bangladesh.<sup>1409</sup> Social Islami Bank was also designated an SCC client.<sup>1410</sup>

**IIRO Remained a Shareholder for Six Years.** In September 2006, Mr. Ketley asked Mr. Mehani to obtain additional information from the Social Islami Bank about its relationship with IIRO.<sup>1411</sup> In response to a question asking whether IIRO was “a customer of the bank,” Mr. Mehani wrote that the bank had told him: “IIRO has no relationship with the subject bank and do[es] not maintain or operate any account with the bank.”<sup>1412</sup> In 2009, however, an internal FIG due diligence report quoted a 2008 local press article stating that the IIRO did have an account at Social Islami Bank, as well as over 50,000 bank shares which FIG estimated might then be worth \$733,000.<sup>1413</sup> In 2010, the HBUS KYC profile referenced a Bangladeshi Central Bank letter dated June 30, 2010, stating that IIRO had accounts at three Bangladeshi banks, including Social Islami Bank, that needed to be closed.<sup>1414</sup> Social Islami Bank told the Subcommittee that IIRO did have a “foreign currency account” with the bank that was opened in 1995, but has a current balance of zero.<sup>1415</sup>

In 2006, Mr. Mehani indicated that the bank planned to “oust” IIRO as a shareholder at its next board of directors meeting and sell IIRO’s bank shares.<sup>1416</sup> Mr. Mehani wrote: “IIRO never responded to their request to provide a full address rather than a PO box and they will use this to oust them by November [2006] which is allowed according to their Articles of Association which I have a copy given by them to me.”<sup>1417</sup> Despite that communication, a 2006 Social Islami Bank board resolution authorizing sale of the shares,<sup>1418</sup> and HBUS’ repeated

<sup>1409</sup> Subcommittee interview of Elizabeth Protomastro (6/9/2012).

<sup>1410</sup> See 2012 HBUS KYC Profile of Social Islami Bank, at 14 (applying SCC designation as of 8/7/2006).

<sup>1411</sup> September 2006 emails between HBUS Alan Ketley, Hersel Mehani and others, “Social Invest Bank Bangladesh, HSBC OCC 3260409-418.

<sup>1412</sup> 9/27/2006 email from HBUS Hersel Mehani to HBUS Alan Ketley and others, “Compliance issues from Trip Dhaka,” HSBC-PSI-PROD-0102755-756 (answer to Question 5).

<sup>1413</sup> 5/5/2009 Financial Intelligence Unit Report of Findings on Social Investment Bank Limited, OCC-PSI-00823818, at 7 (quoting 10/8/2008 article from Bangladeshnews.com). The FIG report also stated: “You may therefore wish to obtain information from your customer to ascertain the status of the accounts held by the IIRO in the Social Investment Bank Ltd. You may also wish to consider the risks, including reputational risk involved in maintaining this account relationship.” Id. at 7-8 (emphasis omitted).

<sup>1414</sup> 2012 HBUS KYC Profile of Social Islami Bank, at 4 (“The 3 bank accounts of IIRO namely i) Social Islami Bank Ltd. ii) Islami Bank Bangladesh Ltd. iii) Al-Falah Islami Bank Ltd. must be disposed off [sic] and transferred”).

<sup>1415</sup> 7/11/2012 Social Islami Bank response to Subcommittee questions, at 4, PSI-SIBL-01-0001.

<sup>1416</sup> 9/27/2006 email from HBUS Hersel Mehani to HBUS Alan Ketley and others, “Compliance issues from Trip Dhaka,” HSBC-PSI-PROD-0102755-756.

<sup>1417</sup> Id. See also 2012 HBUS KYC Profile of Social Islami Bank, at 5 (“Compliance advised ... that IIRO has no involvement in the running of the bank, is not a client of the bank and will likely be ousted as a shareholder [which] give considerable grounds for comfort”).

<sup>1418</sup> See 12/14/2006 letter from Social Islami Bank quoting board resolution, HSBC OCC 3342182.

inquiries into their status over multiple years,<sup>1419</sup> IIRO has remained a shareholder of Social Islami Bank, although its ownership interest has gradually dropped from 8.62% in 2006, to 3.85% in 2009, to 1.69% by 2010.<sup>1420</sup> IIRO currently holds a 1.61% interest in the bank, six years after Social Islami Bank promised to ensure the shares would be sold.<sup>1421</sup>

In 2009, Social Islami Bank sent a letter to HBUS indicating that it was planning to seek permission from the country's High Court to sell the shares still held by IIRO.<sup>1422</sup> In 2010, Social Islami Bank informed HBUS that the Bangladesh government had reached an agreement with IIRO that, after certain safeguards were put in place, would allow IIRO to begin operating in the country again.<sup>1423</sup> One of the conditions was that the IIRO would have to "dispose" of its Social Islami Bank account,<sup>1424</sup> although that account remains open today with a zero balance.<sup>1425</sup> Social Islami Bank informed the Subcommittee that, due to the government's actions, "the bank is under definite obligation in paying dividend/issuing bonus shares/right shares to IIRO as per the instructions of the Central Bank and Ministry of Finance which were not paid/issued in their favor till 31/05/2010."<sup>1426</sup>

**A Second Terrorist Financier Shareholder.** Also in 2009, a due diligence report issued by the HBUS Financial Intelligence Group identified a second, longterm Social Islami Bank shareholder that raised concerns. It disclosed that Islamic Charitable Society Lajnat al-Birr Al

<sup>1419</sup> See, e.g., January 2007 email exchange among HBUS Muhammad Shohiduzzaman, Hersel Mehani, Alan Ketley, and others, "Social Investment Bank – IIRO," OCC-PSI-00808829; 9/23/2008 email exchange among HBUS Alan Williamson, Daniel Jack, Hersel Mahani, and others, "Social Investment Bank," OCC-PSI-00246337; 9/23/2008 email exchange among HBUS Alan Williamson, Daniel Jack, Gloria Strazza, Monique Codjoe, and others, "POSITIVE OFAC MATCH – IIRO – KYC NOTES DATABASE," OCC-PSI-00246334; 9/24/2008 call report from a meeting at Social Islami Bank, HSBC-PSI-PROD-0102615; 3/8/2009 letter from Social Islami Bank to HSBC Dhaka, "Information regarding Bank's ownership for KYC purposes," HSBC-PSI-PROD-0102743, at 1; 2/9/2010 email from HBUS Jon K. Jones to HBAP Sadique Reza and others, "Compliance Conditions: Social Islami Bank Ltd," HSBC-PSI-PROD-0102737.

<sup>1420</sup> See 2012 HBUS KYC Profile of Social Islami Bank at 3-4; 3/8/2009 letter from Social Islami Bank to HSBC Dhaka, "Information regarding Bank's ownership for KYC purposes," HSBC-PSI-PROD-0102743, at 1.

<sup>1421</sup> 7/11/2012 Social Islami Bank response to Subcommittee questions, at 3, PSI-SIBL-01-001; See also 2012 HBUS KYC Profile of Social Islami Bank, at 3, 16.

<sup>1422</sup> 3/8/2009 letter from Social Islami Bank to HSBC Dhaka, "Information regarding Bank's ownership for KYC purposes," HSBC-PSI-PROD-0102621-625, at 1. Around the same time in 2009, HSBC's Commercial and Institutional Banking in the Asia Pacific region further expanded HSBC's relationship with Social Islami Bank by providing it with new commercial banking services. The approval form mistakenly characterized Social Islami Bank as "medium risk," erroneously said it was not an SCC designated client, and stated that none of the bank's disclosed shareholders increased the client's risk profile, despite a specific reference to IIRO. 3/10/2009 CIBM-Institutional Banking KYC Profile for Social Islami Bank Limited, HSBC-PSI-PROD-0102646.

<sup>1423</sup> 2012 HBUS KYC Profile of Social Islami Bank, at 4.

<sup>1424</sup> Id.

<sup>1425</sup> 7/11/2012 Social Islami Bank response to Subcommittee questions, at 2, PSI-SIBL-01-001.

<sup>1426</sup> Id. at 3.

Islam still held a 1.54% ownership interest in the bank.<sup>1427</sup> The 2009 FIG report explained that World Check, the database relied on by HSBC for KYC purposes, had classified the charity “as a terrorist organization with reported tie[s] to Hamas. In September 2008, the Israeli government reportedly declared it an illegal entity.”<sup>1428</sup> Despite this new information in the 2009 FIG report, the HBUS KYC profile on Social Islami Bank does not acknowledge it, stating instead in a note: “Updated EDD [Enhanced Due Diligence] ROF [Report on Findings] received May 5, 2009. Report provided no new, or, up to date information.”<sup>1429</sup> Social Islami Bank has informed the Subcommittee that Lajnat al-Birr remains a 0.22% share owner, but does not have any account at the bank.<sup>1430</sup>

**Sobhan Misconduct.** The ongoing ownership of the bank’s shares by IIRO and Lajnat al-Birr was not the only troubling development. Social Islami Bank’s initial Chairman of the Board, Ahmed Akbar Sobhan, also known as Shah Alam, was a well-known businessman who held, with his son, a 3.35% ownership interest in the bank since its inception.<sup>1431</sup> Beginning in 2006, however, Mr. Sobhan and his son became the subjects of several criminal investigations involving bribery, corruption, fraud, and tax evasion.<sup>1432</sup> In 2007, Mr. Sobhan and his son reportedly fled to the United Kingdom, after which Mr. Sobhan was the subject of corruption charges brought in his absence by the Bangladesh Anti-Corruption Commission which sentenced him to eight years in prison.<sup>1433</sup> This troubling information was detailed in the 2009 FIG report that, inexplicably, was later described in the Social Islami KYC profile as containing no new information.<sup>1434</sup>

In May 2012, HSBC terminated its relationship with Social Islami Bank.<sup>1435</sup> David Bagley, head of HSBC Group Compliance, told the Subcommittee, when asked, that the closure decision had been a “no

<sup>1427</sup> 5/5/ 2009 FIG report, HSBC PSI PROD 0102696, at 3, 5.

<sup>1428</sup> Id. at 5 (emphasis in original is omitted).

<sup>1429</sup> 2012 HBUS KYC Profile of Social Islami Bank, at 4.

<sup>1430</sup> 7/11/2012 Social Islami Bank response to Subcommittee questions, PSI-SIBL-01-0001-004, at 002.

<sup>1431</sup> See “Social Investment Bank Ltd. Director’s Business Information,” Social Islami Bank, undated, HSBC-PSI-PROD-0102626; 2003 Bankers Almanac at 3891 (listing Mr. Sobhan with a 2.12% interest and Mr. Sobhan and his son, Sadat Sobhan, sharing a 1.23% interest).

<sup>1432</sup> See 5/5/2009 Financial Intelligence Unit Report of Findings on Social Investment Bank Limited, HSBC OCC 3261530, at 6-7. See also “Court orders to arrest Bashundhara chairman,” The Daily Star (4/26/2012), <http://www.thedailystar.net/newDesign/news-details.php?nid=231738>; “Shah Alam lands in jail,” The Daily Star (3/21/2011), <http://www.thedailystar.net/newDesign/news-details.php?nid=178563>.

<sup>1433</sup> See 5/5/2009 Financial Intelligence Unit Report of Findings on Social Investment Bank Limited, HSBC OCC 3261530, at 6-7.

<sup>1434</sup> 5/5/2009 Financial Intelligence Unit Report of Findings on Social Investment Bank Limited, HSBC OCC 3261530, at 2, 6-7; 2012 HBUS KYC Profile of Social Islami Bank, at 4.

<sup>1435</sup> 7/11/2012 Social Islami Bank response to Subcommittee questions, PSI-SIBL-01-0001-004, at 002.

brainer.”<sup>1436</sup> He did not explain what factors led to the termination decision. Social Islami Bank currently has no open account with any HSBC affiliate.<sup>1437</sup>

## J. Analysis

HSBC is a global bank with a strong presence in many countries confronting terrorist threats. If safeguards are lacking, HBUS offers a gateway for terrorists to gain access to U.S. dollars and the U.S. financial system. HSBC has a legal obligation to take reasonable steps to ensure it is not dealing with banks that may have links to or facilitate terrorist financing.

Banks rarely carry explicit links to terrorist financing, but in the three banks reviewed here, an array of factors raised troubling questions. In the case of Al Rajhi Bank, the factors included the naming of a key bank official in a list of al Qaeda financial benefactors, a U.S. law enforcement search of Al Rajhi nonprofit and business ventures in the United States to disrupt terrorist financing, a CIA report targeting the bank for being a “conduit” for extremist finance, the bank’s refusal to produce authenticating bank documents for use in the criminal trial of a client who cashed travelers cheques at the bank for use by terrorists, and multiple accounts held by suspect clients. In the case of Islami Bank, the factors included substantial ownership of the bank by al Rajhi interests, Central Bank fines for failing to report suspicious transactions by militants, and an account provided to a terrorist organization. In the case of Social Islami Bank, the factors included ownership stakes held by two terrorist organizations whose shares were exposed but never sold as promised, and a bank chairman found to be involved with criminal wrongdoing.

In each case, HBUS and HSBC personnel were aware of the information, but approved or maintained the accounts anyway. When an AML Compliance officer like Beth Fisher declined to approve an account, HSBC personnel found someone else to take her place. In several cases, Christopher Lok, head of U.S. Banknotes, took on the role of relationship manager fighting for account approval. His test for taking on that role depended in part upon how much revenue an account would produce. Al Rajhi Bank’s threat to terminate business with HSBC affiliates also appears to have galvanized HBUS’ renewal of the account.

Another striking feature of these accounts is the fact that a decision by one HSBC affiliate to terminate a relationship with a bank due to terrorist financing concerns did not always lead other HSBC affiliates to

<sup>1436</sup> Subcommittee interview of David Bagley (5/10/2012).

<sup>1437</sup> 7/11/2012 Social Islami Bank response to Subcommittee questions, PSI-SIBL-01-0001-004, at 002.

follow suit. In the case of Al Rajhi Bank, for example, HBUS terminated the relationship, but HSBC affiliates in the Middle East continued to do business with the bank. One HBUS executive later argued that, since HSBC was already exposed to the reputational risk posed by Al Rajhi Bank through the accounts at other HSBC affiliates, its reputational risk would not increase if one more account were opened. In May 2012, HSBC changed its policy to apply decisions to terminate a client relationship to apply globally to all its affiliates.

## **VI. HOKURIKU BANK: CLEARING BULK TRAVELERS CHEQUES**

With few questions asked and despite ongoing evidence of suspicious activity, HBUS cleared tens of millions of dollars per year in bulk travelers cheques for Hokuriku Bank of Japan. According to Hokuriku Bank, from 2005 to October 2008, HBUS cleared travelers cheques totaling between \$70 million and \$90 million per year for the bank, producing a grand total in less than four years of more than \$290 million. HBUS estimated that, at one point in 2008, it was clearing travelers cheques for the bank at an average of \$500,000 to \$600,000 per day. The Hokuriku deposits consisted of U.S. dollar travelers cheques that were in denominations of \$500 or \$1,000, came in batches of sequentially numbered cheques, and were signed and counter-signed by the same person using an illegible signature. They were made payable to one of 30 different companies or individuals, all of whom claimed to be in the used car business. The cheque beneficiaries were clients of Hokuriku Bank, but the cheques were purchased from the same Russian bank for deposit into their accounts in Japan. When HBUS finally asked Hokuriku Bank about those clients and the business purpose behind Russians cashing massive numbers of U.S. dollar travelers cheques on a daily basis for deposit in Japan, Hokuriku Bank claimed to have little or no KYC information or understanding of its clients' banking transactions.

The documents produced to the Subcommittee disclosed that some HBUS AML Compliance personnel raised concerns about the Hokuriku travelers cheques in 2005, but failed to investigate the transactions. The Hokuriku travelers checks came to HBUS' attention again in 2007, during the course of an OCC AML examination which found "serious concerns related to weak policies, procedures, systems and controls" with how it processed monetary instruments,<sup>1438</sup> but HBUS again failed to investigate the transactions. In 2008, during a followup OCC AML examination, the OCC singled out the Hokuriku travelers cheques as suspicious and required HBUS to obtain additional information about them.

The OCC and HBUS quickly uncovered troubling information about the travelers cheques, including that they had originated in Russia, a country at high risk of money laundering, involved millions of U.S. dollars, and had no clear business purpose. When HBUS sought more information about the cheques, Hokuriku Bank at first delayed responding, then provided minimal information, and finally declined to investigate further, claiming to be constrained by bank secrecy laws

<sup>1438</sup> 3/31/2007 OCC Report of Examination for HSBC bank, OCC-PSI-00304077. [Sealed Exhibit.]

from disclosing client-specific information. In 2008, at the urging of the OCC, HBUS stopped accepting travelers cheques from the bank and told the OCC that it planned to close the Hokuriku account within 30 days. HBUS later decided to continue to do business with Hokuriku Bank in other areas despite its poor AML efforts. In 2010, during the course of another AML examination, the OCC uncovered the ongoing relationship with Hokuriku Bank. In May 2012, HBUS closed the Hokuriku Bank account, although Hokuriku Bank continues to do business with other HSBC affiliates.

#### A. Hokuriku Bank

Hokuriku Bank Ltd. is a Japanese regional bank with over 2,800 employees and 185 branches.<sup>1439</sup> It also has representative offices in New York, London, Singapore, and China.<sup>1440</sup> Hokuriku Bank traces its origins back to 1877; in 1961, it began trading on the Tokyo Stock Exchange.<sup>1441</sup> In 2003, the Hokuin Financial Group was formed in Japan, and Hokuriku Bank became a wholly-owned subsidiary of the Group. In 2004, the Group merged with another financial institution and changed its name to Hokuhoku Financial Group Inc. which continues to operate as the bank's holding company today.<sup>1442</sup> Hokuhoku Financial Group is headed by Shigeo Takagi, who has been the President of both the Group and Hokuriku Bank since 2003.<sup>1443</sup>

According to a 2010 HBUS Know Your Customer (KYC) Profile, Hokuriku Bank is a longstanding customer of HBUS, which has provided it with correspondent banking services in Hong Kong, Korea, and the United Kingdom, as well as the United States.<sup>1444</sup> In addition to HBUS, Hokuriku Bank has correspondent relationships with several other HSBC affiliates as well, including Hong Kong and Shanghai Banking Corporation, Ltd. and HSBC Middle East.<sup>1445</sup> By 2001, Hokuriku Bank had become a client of HBUS' Payments and Cash

<sup>1439</sup> See HBUS "Know Your Customer Profile" for Hokuriku Bank (hereinafter "HBUS KYC Profile") (last updated on 9/3/2010), prepared by HBUS Global Payments and Cash Management division, HSBC-PSI-PROD-0102415-425, at 417; "Hokuhoku Financial Group Inc. Annual Report 2011," (year ended March 31, 2011) (hereinafter "Hokuhoku 2011 Annual Report"), at 59, [http://www.hokuhoku-fg.co.jp/english/financial/docs/fg\\_ar2011.pdf](http://www.hokuhoku-fg.co.jp/english/financial/docs/fg_ar2011.pdf).

<sup>1440</sup> Hokuhoku 2011 Annual Report, at 1, 59.

<sup>1441</sup> See Hokuhoku 2011 Annual Report at 59; HBUS KYC Profile at HSBC-PSI-PROD-0102416.

<sup>1442</sup> Id.

<sup>1443</sup> HBUS KYC Profile at HSBC-PSI-PROD-0102420; Hokuhoku 2011 Annual Report, at 61.

<sup>1444</sup> HBUS KYC Profile at HSBC-PSI-PROD-0102417-418. HBUS told the OCC that it first opened an account for Hokuriku Bank in 1978, through its U.S. predecessor, Marine Midland Bank, which HSBC purchased during the 1980s. 5/15/2012 email from OCC to the Subcommittee, "HSBC – Hokuriku Questions," PSI-OCC-38-0001-002.

<sup>1445</sup> See 6/26/2012 letter from Hokuriku Bank's legal counsel to the Subcommittee, PSI-HokurikuBank-01-0001-016, at 001.

Management (PCM) division which used its processing centers in New York to handle most Hokuriku transactions.<sup>1446</sup>

HBUS provided Hokuriku Bank with two accounts, numbered 50385 and 34738. Account No. 50385 was closed on Feb. 6, 2009, and its balance transferred to Account No. 34738, which remained open until May 2012.<sup>1447</sup> HBUS provided Hokuriku Bank with access to U.S. dollars, primarily by clearing millions of dollars in U.S. dollar travelers checks each year. According to Hokuriku Bank, HBUS cleared travelers cheques totaling about \$77 million in 2005, \$72 million in 2006, \$90 million in 2007, and \$52 million in 2008, until HBUS stopped providing clearing services for the bank's bulk travelers cheques.<sup>1448</sup> Those figures show that, in less than four years, HBUS cleared travelers cheques for Hokuriku Bank totaling over \$290 million. HBUS also processed wire transfers from Hokuriku Bank and provided other banking services. In 2007, the Hokuriku account produced revenues for HBUS totaling about \$47,000.<sup>1449</sup>

According to the HBUS KYC Profile, the initial HBUS Account Manager for Hokuriku Bank was Nanayo Ryan, and the Relationship Manager for KYC approval purposes was Beth Fisher.<sup>1450</sup> In 2008, the HBUS Account Manager switched to Kgomotso Hargraves, while the Relationship Manager for KYC approval purposes switched to Wayne W. Ferguson, then Anthony Julian, then Wen Lu Wu.<sup>1451</sup> The Global Relationship Manager since 2008 has been Machiko Yamashita.<sup>1452</sup>

## B. Travelers Cheques

Travelers cheques are typically sent by one financial institution to another via a "pouch." A pouch is an envelope or package, and pouch activity refers to the sending or receipt and processing of an item that is sent to a bank from another country by common carrier, courier, or referral agent. Pouches typically contain currency or a monetary instrument, such as a travelers cheque, cashiers cheque, or money order, which is intended to be used to make a deposit or loan payment, or to engage in another transaction. Pouches can be sent by an unrelated financial institution, a bank affiliate, or by an entity or individual.

<sup>1446</sup> HBUS KYC Profile at HSBC-PSI-PROD-0102415-425, at 423.

<sup>1447</sup> Id. at 420. HBUS closed the second account on May 21, 2012. 6/26/2012 letter from Hokuriku Bank's legal counsel to the Subcommittee, PSI-HokurikuBank-01-0001-016, at 001.

<sup>1448</sup> See 6/26/2012 letter from Hokuriku Bank's legal counsel to the Subcommittee, chart entitled, "Volume of U.S. Dollar Travelers Checks to HBUS for Clearance by year," PSI-HokurikuBank-01-0001-016. Hokuriku Bank cleared another \$52 million in 2008, until HBUS stopped clearing the cheques in October 2008.

<sup>1449</sup> HBUS KYC Profile at HSBC-PSI-PROD-0102415-425, at 420.

<sup>1450</sup> Id. at 424.

<sup>1451</sup> Id. at 418, 424-425.

<sup>1452</sup> 9/5/2008 email from Hideki Matsumoto to Michio Yamashita and others, "Hokuriku Bank," OCC-PSI-00808695, at 5.



In addition to physical delivery of monetary instruments, many banks, including HBUS, provide a service called “Remote Deposit Capture” (RDC). RDC enables customers who sign up for the service to send electronic images of physical monetary instruments that they wish to present for deposit, including travelers cheques. Processing these electronically sent deposits are sometimes referred to as part of the receiving bank’s pouch activity.

At large banks, pouched monetary instruments are typically sent to a specialized facility for processing. These facilities typically process a high volume of monetary instruments on a daily basis. When a bank processes a pouched travelers cheque, it typically credits the amount of the cheque to the correspondent account of the client financial institution that sent the cheque. Pouch activity is often referred to as “cash letter” activity, since it consists primarily of cashing a monetary instrument by crediting an account with the amount specified on the instrument. Providing cash in exchange for a monetary instrument is also referred to as “clearing” the instrument.

HBUS has two processing centers in the United States, one in Brooklyn and one in Buffalo, New York, both of which process a high volume of monetary instruments on a daily basis. RDC services are provided solely at the Buffalo center.<sup>1453</sup> Both centers segregate travelers cheques from other types of deposits and process them separately, crediting the U.S. dollars to the relevant client accounts.<sup>1454</sup> A processing clerk typically skims each deposit to identify any sequentially numbered travelers cheques. If the sequentially numbered cheques total more than a designated amount, the clerk is required to refer the deposit to HBUS AML Compliance for approval prior to processing.<sup>1455</sup> If the sequentially numbered travelers cheques exceed another specified threshold, the processing clerk must attach a Traveler’s Cheque/Money Order High Value Deposit Information (TC/MO HVDI) form to the deposit prior to processing.<sup>1456</sup> If the form is not attached, the deposit must be submitted to AML Compliance for approval prior to processing.<sup>1457</sup> This procedure is intended to ensure that HBUS AML Compliance is kept apprised of large deposits of sequentially numbered travelers cheques, since such cheques are often associated with money laundering or other misconduct.

<sup>1453</sup> 10/4/2010 draft OCC Supervisory Letter to HBUS, OCC-PSI-00863984-992, at 2. [Sealed Exhibit.]

<sup>1454</sup> 6/26/2008 Memorandum to the OCC Examiner-In-Charge Anthony DiLorenzo from OCC Examiner Elsa de la Garza, “Pouch Transactions – Hokuriku Bank and SK Trading Company Ltd.,” OCC-PSI-00885828, at 1. [Sealed Exhibit.]

<sup>1455</sup> Id.

<sup>1456</sup> Id.

<sup>1457</sup> Id.

U.S. banking regulators have long warned financial institutions about the money laundering risks associated with travelers cheques which can be purchased with cash by a non-customer of the bank and used to move substantial funds across international borders in ways that are difficult to trace.<sup>1458</sup> Travelers cheques have been used by terrorists,<sup>1459</sup> drug traffickers,<sup>1460</sup> and other criminals.<sup>1461</sup>

### C. 2005 Concerns about Hokuriku Travelers Cheques

The documents produced to the Subcommittee show that HBUS AML Compliance personnel were aware of, and expressed concerns about, the large number of travelers cheques being cashed for Hokuriku Bank from at least as early as March 2005, but did little about them for years.

On March 15, 2005, HBUS AML compliance officer George Tsugranes sent an email to the HBUS account manager for Hokuriku Bank, Nanayo Ryan, in which he noted that, in less than 60 days from January to March 2005, Hokuriku Bank had deposited travelers cheques totaling over \$2 million.<sup>1462</sup> The email provided a chart listing 41 separate deposits over a 51-day period, showing that the deposited

<sup>1458</sup> See, e.g., Federal Financial Institutions Examination Council (FFIEC) Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Examination Manual, "Core Overview: Purchase and Sale of Monetary Instruments," (6/23/2005) at 59; FFIEC BSA/AML Examination Manual, "Purchase and Sale of Monetary Instruments-Overview," (8/24/2007), at 212 ("The purchase or exchange of monetary instruments at the placement and layering stages of money laundering can conceal the source of illicit proceeds. As a result, banks have been major targets in laundering operations because they provide and process monetary instruments through deposits.").

<sup>1459</sup> See, e.g., *United States v. al-Haramain Islamic Foundation Inc.*, Case No. 6:05-cr-60008-HO (USDC Oregon) Indictment (2/17/2005); "Former U.S. Head of Al-Haramain Islamic Foundation Sentenced to 33 Months in Federal Prison," U.S. Attorney's Office for the District of Oregon press release (9/27/11), at 1 (describing how the convicted defendant cashed \$130,000 in U.S. dollar travelers cheques at a bank in Saudi Arabia and then provided the funds to support violent extremists in Chechnya).

<sup>1460</sup> See, e.g., *United States v. Wachovia Bank N.A.*, Case No. 10-20165-CR-Lenard (USDC SDFL), Factual Statement, Exhibit A to Deferred Prosecution Agreement (3/16/2010), at ¶ 35 (describing how Wachovia Bank processed \$20 million in suspicious travelers cheques, some portion of which was suspected to include illegal drug proceeds); "How a Big U.S. Bank Laundered Billions from Mexico's Murderous Drug Gangs," *The Guardian*, (4/2/2011), <http://www.guardian.co.uk/world/2011/apr/03/us-bank-mexico-drug-gangs>. See also *Albajon v. Gugliotta*, 72 F. Supp. 2d 1362, 1365 (S.D. Fla. 1999) (admitting travelers cheques as evidence of drug trafficking proceeds); *United States v. \$41,305.00 in Currency & Travelers Checks*, 802 F.2d 1339, 1343 (11th Cir. 1986) (finding travelers cheques could be seized as drug trafficking proceeds).

<sup>1461</sup> See, e.g., *Folk v. State*, 192 So. 2d 44, 46 (Fla. Dist. Ct. App. 1966) (upholding conviction for signing a false name on travelers cheques and cashing them); *United States v. Sebaggala*, 256 F.3d 59, 63 (1st Cir. 2001) (upholding conviction for using undeclared travelers cheques to attempt to move money fraudulently through U.S. customs).

<sup>1462</sup> 3/15/2005 email from HBUS George Tsugranes to HBUS Nanayo Ryan, "Hokuriku Bank C/L Activity," HSBC OCC 3113976-977. The chart is unlikely to contain a comprehensive list of all of the travelers cheques presented by Hokuriku Bank over the course of those two months since, during 2005 alone, Hokuriku Bank cleared \$77 million in travelers cheques through HBUS. See 6/26/2012 letter from Hokuriku Bank's legal counsel to the Subcommittee, chart entitled, "Volume of U.S. Dollar Travelers Checks to HBUS for Clearance by year," PSI-HokurikuBank-01-0001.

amounts ranged from \$20,000 to \$100,000 at a time; often consisted of multiple \$1,000 travelers cheques; and referenced about ten different clients, including corporations and individuals.<sup>1463</sup> All of the deposits were to Hokuriku Bank's Account No. 50385. Mr. Tsugranes asked Mr. Ryan:

“to reach out to the bank and ask that adequate KYC is on file for each name listed on the spreadsheet, whether the customer activity is consistent with the KYC, and also who is their customer base (local clients, people buying cars for export, etc.) and why US dollar travelers checks would be used for payment.”<sup>1464</sup>

This email shows that, in early 2005, Hokuriku's pattern of making large deposits with multiple travelers cheques triggered a review by HBUS AML Compliance personnel concerned about who was behind the deposits. Despite the request for more information in the March 2005 email, the Subcommittee received no additional documentation or information indicating that HBUS AML Compliance personnel actually sought or obtained additional KYC information from Hokuriku Bank in early 2005, regarding the travelers cheques it was cashing.

Eight months later, in November 2005, several emails indicate that HBUS AML Compliance personnel took a broader look at the cash letter/pouch activity at its Brooklyn center, apparently in an effort to detect unlicensed money service business activity.<sup>1465</sup> This inquiry was not specific to Hokuriku Bank. On Nov. 23, 2005, HBUS AML senior compliance officer Alan Ketley sent an email to AML compliance officer Mark Balawender stating that, while HBUS had “strong monitoring procedures in place for PCM clients,” he wasn't sure about what was “in place for other clients” at the Brooklyn center. He attached to the email a 21-page chart listing the “cash letter volume” for 35 bank clients over a one-year period from April 2004 to March 2005.<sup>1466</sup> The data disclosed, among other information, that over the course of the year, Hokuriku Bank had cashed an increasingly larger volume of monetary instruments each month into its Account No. 50385, building from 36 items totaling about \$209,000 in April 2004, to 109 items totaling over \$4.3 million in March 2005. Altogether for the year, Hokuriku Bank is recorded as having deposited at HBUS 562 “envelopes” with over 24,000 items totaling \$11.2 million.<sup>1467</sup>

<sup>1463</sup> 3/15/2005 email from HBUS George Tsugranes to HBUS Nanayo Ryan, “Hokuriku Bank C/L Activity,” HSBC OCC 3113976-977.

<sup>1464</sup> Id.

<sup>1465</sup> See email exchange among HBUS AML Compliance personnel, from 11/23/2005 - 11/29/2005, HSBC OCC 3180772-797, at 773 (“I do not believe there are any formal or documented checks in place that would identify potential unlicensed money service business activity”).

<sup>1466</sup> Id. at 776-797.

<sup>1467</sup> Id. at 776.

On November 25, 2005, Mr. Balawender sent an email to Mr. Ketley with his findings.<sup>1468</sup> He described the Brooklyn center as engaged in “heads down volume process[s]ing.” He stated, “Given the volume/deadline driven/processing nature of the departments above, I am not sure what we can do. ... I would anticipate a rather strong push-back from Ops and the branches, if AML Compliance were to suggest additional processes.”<sup>1469</sup>

No further information or inquiries related to Hokuriku Bank appear in the 2005 timeframe among the documents provided to the Subcommittee in response to a broad request for all documents related to Hokuriku Bank and pouch activity. When asked for more information about the March and November 2005 reviews, Mr. Ketley indicated that he could not recall either Hokuriku Bank or what happened in either review.<sup>1470</sup>

In sum, despite a specific March 2005 AML inquiry into \$2 million in travelers cheques cleared for Hokuriku Bank, and a broader November 2005 inquiry that included evidence of an escalating pattern of Hokuriku deposits, HBUS AML Compliance apparently took no further action to investigate Hokuriku’s cash letter activities in 2005. The 2005 and 2006 OCC annual examination of HBUS also made no mention of AML issues related to its pouch activities or clearance of travelers cheques.<sup>1471</sup>

#### **D. 2007 OCC Pouch Examination**

Two years after the internal HBUS inquiries, in early 2007, the OCC commenced an AML examination of HBUS’ pouch activities.<sup>1472</sup> In response, HBUS AML compliance officer George Tsugranes produced a chart listing clients with a high volume of cash letter activity during the last two months of 2006.<sup>1473</sup> Hokuriku Bank was repeatedly listed, appearing in the chart more times than any other bank. Over a 62-day period, the chart identified 100 Hokuriku deposits. The deposit amounts ranged from \$20,000 to \$193,000 at a time, often consisted of multiple \$1,000 travelers cheques, and referenced about a dozen clients, both corporate and individual.<sup>1474</sup> Many of the client names on the 2006

<sup>1468</sup> Id. at 773.

<sup>1469</sup> Id.

<sup>1470</sup> Subcommittee interview of Alan Ketley (2/16/2012).

<sup>1471</sup> See OCC Reports of Examination of HBUS, for the examination cycle ending March 31, 2005 and March 31, 2006. [Sealed Exhibit.]

<sup>1472</sup> See 5/8/2007 OCC Memorandum, “BSA/AML Examination – HSBC, USA, NA – Pouch Activities,” OCC-PSI-01298647 [Sealed Exhibit.]; 3/2/2007 email from HBUS George Tsugranes to HBUS Alan Ketley, HSBC OCC 3352026.

<sup>1473</sup> See chart, prepared by HBUS AML Compliance, HSBC OCC 3352034-037.

<sup>1474</sup> Hokuriku Bank told the Subcommittee that, since the mid 1980s, it has limited its clients to deposits of no more than \$1,000 in travelers cheques per person per day, unless the cheques were issued by Hokuriku Bank or the depositor was a “regular customer” and the bank “deemed that

list had also appeared on the March 2005 list compiled by Mr. Tsugranes. The total amount deposited over the two-month period was about \$5.6 million.

Mr. Tsugranes sent the chart to his supervisor, Mr. Ketley, and wrote that “all acc[oun]ts are being checked to ensure activity is reflected on KYC.” Of the documents produced to the Subcommittee, none indicate, however, what information was “checked” with respect to Hokuriku Bank or what Mr. Tsugranes learned.

Six weeks later, on April 24, 2007, Mr. Ketley asked HBUS AML compliance officers Mr. Tsugranes and Robert Guthmuller, to travel to the HBUS Brooklyn center “to gain a thorough understanding of what is processed ... [and] what items are reviewed.”<sup>1475</sup> Three days later, on April 27, 2007, Mr. Guthmuller sent an email to Mr. Ketley providing him with “the Readers Digest version” of their findings after “a high level review of cash letter processing” at the Brooklyn center.<sup>1476</sup>

Mr. Guthmuller’s email stated that the Brooklyn center “treat[ed] all clients the same,” regardless of whether cash letter items involved “high risk clients.” He wrote: “We should be drilling down on our high risk customers” and, for example, “identify those clients that in the past have sent a large number of sequentially numbered travelers checks ... and monitor accordingly.”<sup>1477</sup> Mr. Guthmuller also wrote that the center staff had “divided loyalty,” explaining:

“Their main job is processing checks – 5:00PM deadline. But they are also asked to be the ‘front line’ for monitoring, referring items to Delaware for further investigation. One job focuses on pushing items through, another is to go slower, review items, ask themselves questions – is it suspicious? – contact Delaware – wait for a response – hopefully before 5:00PM.

[O]ne solution is to have a full time compliance person review items FULLY, that means internet searches, OFAC, wor[l]dcheck etc. Additionally the compliance person could drill down on the high risk accounts.”<sup>1478</sup>

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the funds will be collected from the customer should it turn out that the travelers’ che[c]k was not duly issued.” 6/26/2012 letter from Hokuriku Bank’s legal counsel to the Subcommittee, PSI-HokurikuBank-01-0001-016, at 004.

<sup>1475</sup> 4/23/2007 email from HBUS Alan Ketley to HBUS George Tsugranes, Robert Guthmuller, Mark Balawender, and others, “Visit to Brooklyn Ops,” OCC-PSI-00312153, at 5-6.

<sup>1476</sup> 4/27/2007 email from HBUS Robert Guthmuller to HBUS Alan Ketley, “Visit to Brooklyn OpsLink,” OCC-PSI-00312153, at 4.

<sup>1477</sup> Id. at 5.

<sup>1478</sup> Id. at 5 (emphasis in original).

Mr. Guthmuller also stated that HBUS “[m]ust improve trend analysis. Nothing done in Brooklyn.” He wrote:

“We have reportedly had all travelers checks \$20k and over ... on Excel for 4 years but haven’t used/sorted items for trend analysis. Let’s start looking at it. WHAT ABOUT SEQUEN[T]IALLY NUMBERED TRAVELERS CHECKS AGGREGATING SAY \$15K per day, same payee ...?”<sup>1479</sup>

This email indicated that HBUS had compiled an extensive database of travelers cheque information, but was not using it to identify suspicious travelers cheque activity or high risk clients.

Mr. Guthmuller also wrote that the HBUS AML office in Delaware “must improve” its enhanced due diligence (EDD) efforts, including by using “more internet searches, calls on high risk clients asking questions, use of certifications, etc.”<sup>1480</sup> His email indicated that HBUS’ AML staff did not engage in sufficient due diligence activity to identify high risk clients depositing bulk travelers cheques.

Mr. Ketley forwarded the email to Anne Liddy, a senior HBUS Compliance official, with the comment, “Food for thought.”<sup>1481</sup> He wrote: “We will look to have a meeting with Bob [Guthmuller] next week to discuss further.”

Ten days later, on May 7, 2007, Mr. Tsugranes sent an email to Mr. Ketley and others stating he had “discussed the issues with the Delaware AML team and asked for some input on ways to improve our cash letter monitoring.”<sup>1482</sup> He stated: “Below are some recommendations which will allow for both operational benefits and a more risk based monitoring approach.”

His email advised reducing the monitoring of checks from Fortune 100 names, and revising the dollar limit to \$100,000 to trigger review of an account of a Special Category Client (SCC). While reducing review of Fortune 100 names could be seen as an effort to target AML review efforts to higher risk transactions, imposing a \$100,000 dollar limit on SCC clients, the bank’s highest risk clients, set a high bar to trigger a review. With respect to Hokuriku Bank and another bank in Korea, Mr. Tsugranes advised that AML personnel track the banks’ total daily deposits, “eliminate the check by check comparison,” and “only investigate if an apparent MIF [Monetary Instrument Form] was not included.” He wrote: “To summarize we

<sup>1479</sup> Id. at 5 (emphasis in original).

<sup>1480</sup> Id. at 5.

<sup>1481</sup> Id. at 4.

<sup>1482</sup> Id. at 2-3.

would be focusing more on SCC clients, cutting back on some Group reviews in non HRCs [non High Risk Clients] and also tracking” a specific bank of concern.

While the Tsugranes email advocated a stronger focus on SCC clients, it did not address Mr. Guthmuller’s suggestion to identify other high risk clients by analyzing the bank’s travelers cheque data. His email did not, for example, include the Guthmuller suggestion to strengthen trend analysis of the cash letter activity at the Brooklyn center by utilizing the four years of travelers cheque data already included in Excel spreadsheets. The Tsugranes email also failed to include the suggestion, urged in capital letters in the Guthmuller email, to identify and investigate clients making deposits of sequentially numbered travelers checks above a specified threshold. Instead, the Tsugranes email recommended reducing the monitoring directed toward Hokuriku Bank by eliminating the “check by check comparison” that had been routine practice. In the end, despite another chart disclosing multi-million-dollar Hokuriku deposits of \$1,000 travelers checks, the final result of HBUS’ review was to advocate devoting less rather than more attention to the bank.

The two OCC examiners who conducted the 2007 examination told the Subcommittee that they were very concerned about the lack of AML controls over HBUS pouch activity and had recommended that the OCC impose a Cease and Desist Order requiring HBUS to revamp them.<sup>1483</sup> They later concluded, however, that they were unable to meet the OCC standards required for issuing the order. Instead, the OCC examiners designated the lack of AML controls over pouch processing as a Matter Requiring Attention (MRA) which was included in the annual OCC Report of Examination provided to the HBUS Board of Directors on July 24, 2007.<sup>1484</sup> The MRA did not, however, explicitly identify the Hokuriku travelers cheques as a problem.

The OCC uses its annual Reports on Examinations to ensure bank boards are kept apprised of serious bank deficiencies requiring action by

<sup>1483</sup> See 7/3/2007 OCC memorandum, “BSA/AML Examination – HSBC, USA, NA – Pouch Activities,” OCC-PSI-0087773 [Sealed Exhibit.]; Subcommittee interviews of Joseph Boss (1/30/2012) and Elsa de la Garza (1/9/2012).

<sup>1484</sup> 7/24/2007 OCC Report of Examination of HBUS, for the examination cycle ending March 31, 2007, OCC-PSI-00304077, at 1. [Sealed Exhibit.] The MRA read in full as follows:

“The bank provides pouch services in a number of business units. An examination of HSBC pouch services resulted in serious concerns related to weak policies, procedures, systems and controls. The policies and controls in this area are inferior to BSA/AML controls in other areas of the bank, and remedial action is warranted. The absence of comprehensive policies, procedures and adequate systems and controls could potentially subject the bank to undue reputation risk and/or lead to BSA/AML violations. Pouch services facilitate easy movement of funds, and are favored by persons who transfer illegal and terrorist funds. Consequently, the Board should ensure that management implements appropriate policies, procedures, systems and controls for this activity. The Board should communicate the corrective measures to the OCC, and confirm subsequent resolution.”

management. The 2007 Report of Examination notified the HBUS Board about the OCC's "serious concerns related to weak policies, procedures, systems and controls" related to its pouch activities, and urged immediate improvements.<sup>1485</sup> In September 2007, the OCC also issued a Supervisory Letter to HBUS which again urged that "policies, procedures, systems, and controls for pouch need strengthening and augmenting."<sup>1486</sup>

### **E. 2008 OCC Inquiry into Hokuriku Travelers Cheques**

Nine months later, in June 2008, the OCC commenced a followup AML examination of HBUS pouch activity, looking at pouch services in additional business units.<sup>1487</sup> During the course of that examination, OCC examiners identified the Hokuriku travelers cheque deposits as an activity warranting greater scrutiny.<sup>1488</sup>

In June 2008, two OCC AML bank examiners visited the HBUS Brooklyn and Buffalo processing centers to examine their pouch activity.<sup>1489</sup> One of the examiners told the Subcommittee that when they visited the Brooklyn center, they found "stacks and stacks of travelers cheques, some signed and countersigned by the same entity."<sup>1490</sup> In a memorandum the examiner wrote that, at the Brooklyn center, she reviewed a Hokuriku cash letter deposit in the amount of \$110,000, and found it consisted of 220 sequentially numbered travelers cheques, each for \$500.<sup>1491</sup> She wrote that all of the cheques were signed and countersigned by the same individual, whose name was illegible, and all were made payable to SK Trading Company Ltd. The TC/MO HVDI form attached to the deposit described SK Trading as a "used car dealer" and stated that the travelers cheque funds were to be used for a "business purpose."<sup>1492</sup> The other examiner reviewed another Hokuriku deposit for \$240,000 and found a similar situation involving sequentially numbered \$1,000 travelers cheques that had been signed and countersigned by the same person as the other deposit and made payable to SK Trading. The OCC examiners then contacted the HBUS cash letter department manager who explained that the Brooklyn center received three to five Hokuriku deposits daily of travelers cheques which totaled between \$500,000 and \$600,000 each day.<sup>1493</sup> He

<sup>1485</sup> Id.

<sup>1486</sup> 9/13/2007 OCC Supervisory Letter, "Pouch Services and Middle Market at HBUS," OCC-PSI-00000391-394. [Sealed Exhibit.]

<sup>1487</sup> See 6/26/2008 OCC memorandum, "Pouch Transactions – Hokuriku Bank and SK Trading Company Ltd," OCC-PSI-00885822-826. [Sealed Exhibit.]

<sup>1488</sup> Id.

<sup>1489</sup> Id.

<sup>1490</sup> Subcommittee interview of OCC AML Examiner Elsa de la Garza, (1/9/2012).

<sup>1491</sup> 6/26/2008 OCC memorandum, "Pouch Transactions – Hokuriku Bank and SK Trading Company Ltd," at OCC-PSI-00885822, at 1. [Sealed Exhibit.]

<sup>1492</sup> Id.

<sup>1493</sup> Id. at 2.



indicated that travelers cheques were the “only types of instruments received through pouch for Hokuriku Bank.”<sup>1494</sup>

The OCC examiners researched SK Trading and found that, according to its website, the company appeared to be headquartered in Seoul, Korea, with offices in Japan and the United States, and had been in business since 1984.<sup>1495</sup> They also found that the company had been identified by other financial institutions as involved with suspicious activity. These other financial institutions had identified suspicious wire transfers, sometimes involving millions of dollars, which were originated by individuals with Russian surnames who sent the funds from accounts at Russian banks or which were originated by corporations that sent the funds from banks in the British Virgin Islands.<sup>1496</sup> The ultimate beneficiary of the funds in each case was SK Trading using accounts at various banks in Japan. The OCC examiners noted that, in November 2006, one of the financial institutions had contacted Hokuriku Bank directly and asked it about the business purpose behind the transactions, but was told that Hokuriku Bank “could not answer this as their customer (S.K. Trading Company Limited) refused to provide information.”<sup>1497</sup>

The OCC examiners concluded that SK Trading was “conducting high dollar volumes of activity utilizing wire transfers and pouch services,” that SK Trading was involved with “numerous entities,” and that the transactions involved “numerous individuals from Russia,” and warranted additional investigation.<sup>1498</sup> The travelers cheques’ connections to Russia raised a particular red flag, since the United States has long viewed Russia as a country of “primary” money laundering concern, its highest risk category.<sup>1499</sup> At the time, a 2008 report by the U.S. State Department, then the latest in a long line of annual U.S. State Department reports summarizing money laundering concerns on a country-by-country basis, described Russia as follows:

“Criminal elements from Russia and neighboring countries continue to use Russia’s financial system to launder money .... Experts believe that most of the illicit funds flowing through Russia derive from domestic criminal activity, including evasion of tax and customs duties and smuggling operations. Despite making progress in combating financial crime, Russia remains vulnerable to such activity because of its vast natural resource wealth, the pervasiveness of organized crime, and, reportedly, a high level of

<sup>1494</sup> Id.

<sup>1495</sup> Id.

<sup>1496</sup> Id.

<sup>1497</sup> Id. at 3. (emphasis omitted).

<sup>1498</sup> Id. at 4.

<sup>1499</sup> See, e.g., “International Narcotics Control Strategy Report, Volume II, Money Laundering and Financial Crimes,” U.S. State Department (March 2008), at 62.

corruption. Other vulnerabilities include porous borders, Russia's role as a geographic gateway to Europe and Asia, a weak banking system with low public confidence in it, and under funding of regulatory and law enforcement agencies. Russia's financial intelligence unit (FIU) estimates that Russian citizens may have laundered as much as U.S. \$11 billion in 2007."<sup>1500</sup>

When the Subcommittee asked the OCC about its 2008 inquiry into the Hokuriku travelers cheques, Ms. de la Garza stated that, despite the earlier AML examination in 2007, HBUS seemed to have no AML policies or procedures in place regarding pouch activity.<sup>1501</sup> She characterized the failure to monitor the travelers cheques being cashed as "not normal," and stated that they immediately brought the matter to the attention of HBUS AML Compliance. Ms. de la Garza indicated that, at first, HBUS Compliance personnel asserted that the travelers check transactions were legitimate, and that the high cost of cars in Russia accounted for the daily deposits of \$500,000 or more by SK Trading. After doing additional research and finding additional accounts with high volumes of traveler cheque deposits, often sequentially numbered and signed and countersigned by the same person, she said that HBUS AML Compliance became more concerned.<sup>1502</sup>

On Sept. 2, 2008, the OCC examiners met with HBUS senior compliance officials Anne Liddy and Mary Ann Caskin.<sup>1503</sup> According to an OCC memorandum summarizing the meeting, Ms. Liddy disclosed that HBUS had reviewed:

"all transactions over the past 2 months and identified a total of 20 entities (including SK Trading) which were using Cash Letter services to clear Travelers Cheques. All 20 entites are used car dealerships. ... Four additional companies with significant dollar amounts have been identified. (Maric Trading - \$3.5 Million; Jamsou Traders - \$1Million; I K Auto - \$929 Thousand and Dean Corp - \$587 Thousand – totals for two months). ... The Business Unit has gone back to the Relationship Manager and Hokuriku Bank to obtain additional information on Maric Trading and Jamsou Traders. They will also be inquiring on the other companies identified. ... The bank will be exiting the Hokuriku relationship within the next 30 days."<sup>1504</sup>

<sup>1500</sup> Id. at 390. See also "International Narcotics Control Strategy Report, Volume II, Money Laundering and Financial Crimes," U.S. State Department (March 2012), at 156 (identifying generally the same AML vulnerabilities in Russia today).

<sup>1501</sup> Subcommittee interview of OCC AML Examiner Elsa de la Garza (1/9/2012).

<sup>1502</sup> Id.

<sup>1503</sup> 9/3/2008 OCC memorandum, "SK Trading Co Update," OCC-PSI-00885817. [Sealed Exhibit.]

<sup>1504</sup> Id.

The OCC informed the Subcommittee that the two OCC examiners who attended the meeting understood HBUS to mean that it would close the Hokuriku account, cease all business with the bank, and report any suspicious activity to U.S. law enforcement.<sup>1505</sup>

#### **F. Absence of Hokuriku Bank KYC Information**

In July 2008, in response to the OCC, HBUS AML Compliance initiated a more in-depth review of the Hokuriku travelers cheques. A search of HBUS processing records determined that, over a 12-month period from 2007 to 2008, HBUS had received an average of 7,800 travelers checks per month from the bank with an average monthly value of about \$7.4 million.<sup>1506</sup> HBUS determined that “[a]ll deposits are Travellers Checks, no Money Orders found.”<sup>1507</sup> An HBUS AML Compliance officer also noted: “They seem to sell traveler’s checks which are used to purchase cars in Japan. The purchasers of the cars often provide Russian passports as ID.”<sup>1508</sup>

To find out more, on July 15, 2008, HBUS AML compliance officer Stephanie Napier sent an email to Yumi Seto at HSBC Tokyo, PCM Client Service, informing her that HBUS had undertaken a review of Hokuriku Bank Account No. 34738 and asking her to obtain specified KYC information related to certain deposits into that account.<sup>1509</sup> The Subcommittee was unable to determine why the email asked only about Hokuriku Account No. 34738 and not also Account No. 50385, where the travelers cheques were typically deposited.<sup>1510</sup> Nor was the Subcommittee able to determine why the email requested information about only four entities associated with the travelers cheque deposits: De Araujo Roseli Aparecida (an individual), Aksys Corp., R S Corp., and Sanhu Corp.<sup>1511</sup>

Ms. Napier made repeated requests for the information over the next two months without success.<sup>1512</sup> Her HSBC contact in Tokyo, Ms. Seto, repeatedly responded to her emails that Hokuriku Bank had

<sup>1505</sup> 5/15/2012 email from OCC to the Subcommittee, “HSBC – Hokuriku Questions,” PSI-OCC-38-0001-002.

<sup>1506</sup> 7/16/2008 email from HBUS Jonathan Dean to HBUS Mary Ann Caskin and others, “Hokuriku Bank,” OCC-PSI-00407498, at 1.

<sup>1507</sup> Id.

<sup>1508</sup> Id.

<sup>1509</sup> Email exchange among HBUS personnel, from July to Sept. 2008, “Hokuriku Bank Ltd-Compliance Inquiry,” OCC-PSI-00409214-216, at 8-9.

<sup>1510</sup> See chart accompanying 3/15/2005 email from HBUS George Tsugranes to HBUS Nanayo Ryan, “Hokuriku Bank C/L Activity,” HSBC OCC 3113976-977; chart accompanying email exchange among HBUS AML Compliance personnel, from 11/23/2005 - 11/29/2005, HSBC OCC 3180776-797; chart prepared by HBUS AML Compliance in 2007 regarding transactions in 2006, HSBC OCC 3352034-037.

<sup>1511</sup> Email exchange among HBUS personnel, from July to Sept. 2008, “Hokuriku Bank Ltd-Compliance Inquiry,” OCC-PSI-00409214 and attachment OCC-PSI-00409215-216, at 9.

<sup>1512</sup> Id. at 4-8.

indicated it was preparing a “report.”<sup>1513</sup> In September 2008, Ms. Seto was replaced by Ako Kobayashi who, after several attempts, obtained a single, handwritten page from the bank with the requested information.<sup>1514</sup> Because the information was provided in Japanese, she translated it and, on September 9, 2008, sent both the original and her typed translation to Ms. Napier’s supervisor in HBUS AML Compliance Judy Stoldt.<sup>1515</sup>

The information provided by Hokuriku Bank was minimal. In the case of the one individual who had been identified, Hokuriku Bank reported that he was a “Business man,” gave his address, and stated that he worked with a company called “Sugimoto,” and had a “Satisfactory” relationship with the “Originator.” In the case of the three corporations, Hokuriku Bank stated that each was involved in “Sales of Used Cars,” which HBUS already knew, and provided the company’s address, the date of establishment, and whether it was a private corporation or publicly traded. Hokuriku Bank also provided the name of one beneficial owner of one company, but wasn’t sure of the spelling of his name. No reasons were given for its clients using sequentially numbered travelers cheques, having the same person sign and countersign them, or generating the high daily volume of cheques. Ms. Stoldt forwarded the information to HBUS senior Compliance official, Anne Liddy, characterizing it as “very limited information that took us over a month to get.”<sup>1516</sup>

#### **G. 2008 Decision to Stop Cashing Hokuriku Travelers Cheques**

On September 4, 2008, even before the KYC information from Hokuriku Bank was formally translated, HBUS PCM Compliance officer Alan Williamson sent an email to multiple HBUS personnel informing them that HBUS would no longer accept bulk travelers cheques from Hokuriku Bank for processing. He explained:

“Compliance meets monthly with senior management in the Payments and Cash Management AML Management Review Committee. Recently we discussed the fact that Hokuriku has been sending a large number of sequential traveller’s checks from a number of similar businesses through cash letter here in the US. This use of cash letter is inappropriate and the Committee has concluded that PCM should no longer allow Hokuriku to send

<sup>1513</sup> Id. at 5-7.

<sup>1514</sup> Id. at OCC-PSI-00409215.

<sup>1515</sup> Id. at OCC-PSI-00409216.

<sup>1516</sup> Email exchange among HBUS personnel, from July to Sept. 2008, “Hokuriku Bank Ltd-Compliance Inquiry,” OCC-PSI-00409214, at 1. The time period was actually closer to two months.

traveler's checks through cash letter. Hokuriku should therefore cease the activity and make alternative arrangements, such as to make the deposits by wire, by September 30.”<sup>1517</sup>

The task of informing Hokuriku Bank was given to Machiko Yamashita, an HSBC employee in Tokyo who was then the designated Global Relationship Manager for Hokuriku Bank.<sup>1518</sup> On September 11, 2008, he and a colleague met with Hokuriku officials who provided additional information about the travelers cheque deposits and asked HBUS to continue clearing them. According to Mr. Yamashita, Hokuriku Bank explained:

“–Most of their customers related to this issue are used-car dealers for Russian buyers who are cash account holders of Hokuriku Bank through appropriate AML process.  
–The dealers are doing cash on delivery type of deals with buyers in this market therefore cash or TCs [travelers cheques] are normally used to accommodate those deals. As such Hokuriku Bank considers it is difficult for its customers to shift their payment method to wire transfers or commercial check[s] from TCs. ...  
–Since relevant customers are limited [to] around 20 – 25 names and they are all cash account holders of Hokuriku Bank, Hokuriku Bank is well prepared to cooperate with HBUS by providing necessary information.”<sup>1519</sup>

The email also stated: “HBUS is currently the sole Cash Letter provider for Hokuriku Bank.”<sup>1520</sup>

The next day, Anthony Julian responded that HBUS senior management had already reviewed the matter extensively “and determined that we can not continue to support this business. Th[i]s is not an issue for negotiation with Hokuriku.”<sup>1521</sup> Mr. Yamashita replied, in that event, Hokuriku Bank had requested additional time to consider whether to end the business or find a replacement service provider. He wrote: “We suggest that we should withdraw very carefully given the fact that Japanese regional banks’ world is very small. If we will push Hokuriku drastically, HSBC may likely have bad reputation on our PCM business in this marketplace.”<sup>1522</sup>

<sup>1517</sup> 9/4/2008 email from HBUS Alan Williamson to HBUS Anthony Julian and others, “Hokuriku Bank,” OCC-PSI-00808896, at 5.

<sup>1518</sup> Emails among HBUS and HSBC personnel from Sept. to Nov. 2008, “Hokuriku Bank,” OCC-PSI-00808695, at 5.

<sup>1519</sup> Id. at 4.

<sup>1520</sup> Id.

<sup>1521</sup> Id. at 2-3. See also email exchange among HBUS and HSBC personnel from 9/4 to 9/11/2008, OCC-PSI-00196439, at 1.

<sup>1522</sup> Email exchange among HBUS and HSBC personnel from Sept. to Nov. 2008, “Hokuriku Bank,” OCC-PSI-00808695, at 2.

A month later, on October 17, 2008, Mr. Julian sent an email to Albert Halley, head of the cash letter department at the Brooklyn processing center, advising him that Hokuriku Bank had been informed verbally and by letter that HBUS would “no longer accept bulk deposits” of travelers cheques “in excess of \$5,000.”<sup>1523</sup> Mr. Julian advised Mr. Halley that, after October 31, 2008, any bulk travelers cheques received from the bank should be “returned to Hokuriku” via overnight mail. Mr. Halley responded that he had been told to return “any deposits” from Hokuriku Bank after October 31 – not just deposits in the form of travelers cheques – and asked Jonathan Dean in Compliance to “confirm/clarify this new request.”<sup>1524</sup> After consulting with his supervisors, Mr. Dean clarified that no travelers cheques could be accepted from Hokuriku Bank, but that other commercial items could still be processed.<sup>1525</sup> Mr. Dean wrote that he expected the remaining volume to be “extremely low” and asked Mr. Halley to report on the types of checks received from Hokuriku Bank after October 31. This decision to continue the correspondent relationship varied from the September memorandum which stated that senior HBUS AML Compliance official Anne Liddy told the OCC examiners that HBUS would be “exiting the Hokuriku relationship within the next 30 days.”<sup>1526</sup>

## **H. Hokuriku Bank’s Continued Lack of Cooperation**

Even after informing Hokuriku Bank that it would no longer process any travelers cheques, HBUS AML Compliance continued to seek KYC information from the bank in connection with the originators of the travelers cheques, in order to complete an analysis of the transactions and determine whether they involved suspicious activity and had to be reported to law enforcement.

In late November or early December 2008, HBUS Compliance provided an update to the OCC about its efforts. According to an OCC memorandum summarizing the updated information, after receiving an inquiry from HBUS, the company issuing the travelers cheques dispatched investigators to the Russian bank where the travelers checks were being purchased.<sup>1527</sup> The OCC report stated:

<sup>1523</sup> 10/17/2008 email from HBUS Anthony Julian to HBUS Albert Halley and others, “Hokuriku Bank,” OCC-PSI-00808896, at 4-5.

<sup>1524</sup> 10/20/2008 email from HBUS Albert Halley to HBUS Anthony Julian, Jonathan Dean, and others, “Hokuriku Bank,” OCC-PSI-00808896, at 4.

<sup>1525</sup> Email exchange among HBUS personnel, from 10/20-10/31/2008, “Hokuriku Bank,” OCC-PSI-00808896, at 1-3.

<sup>1526</sup> See 9/3/2008 OCC memorandum, “SK Trading Co Update,” OCC-PSI-00885817. [Sealed Exhibit.]

<sup>1527</sup> 12/1/2008 OCC memorandum, “SK Trading,” OCC-PSI-00888526. [Sealed Exhibit.]

“The result was that five individuals were identified who were purchasing the travelers checks with cash at the bank. The five individuals were then providing the checks to Mr. Alexander Tokarenko who is the owner of SK Trading. Mr. Tokarenko then stamped the checks payable to SK Trading.”

All five individuals were Russians living in Russia. The memorandum stated that HSBC was attempting to determine if Mr. Tokarenko owned, not only SK Trading, but also the 29 other entities that had been identified as clearing bulk travelers cheques with HBUS. The OCC memorandum reported that “the total dollar amount of bulk travelers’ checks processed by HSBC for the 30 entities during the period of November 2007 to October 2008 was over \$61 million.”<sup>1528</sup>

In late November 2008, HBUS AML Compliance personnel drafted a new information request and asked Stephanie Brown to forward it to Hokuriku Bank. It asked whether five named Russians (identified in the earlier investigation) were or had been account signatories or “connected in any way” with the accounts opened by 30 specified corporations and individuals involved with the bulk travelers cheques.<sup>1529</sup> Ms. Brown forwarded the request to Ako Kobayashi at HSBC in Tokyo who, in turn, sent it to Hokuriku Bank.<sup>1530</sup>

On December 3, 2008, Ms. Kobayashi sent an email to Ms. Brown indicating that Hokuriku Bank had raised the following questions:

“What is the background for your queries? Does it relate to your compliance reason or does it relate to criminal act and the police asks such information? Where did you get those Russian names? Since no cheques has been presented to you since Nov08, why such information is required now?”<sup>1531</sup>

HBUS explained that the information was needed to complete an internal investigation, and was not being requested in connection with a criminal prosecution.<sup>1532</sup> Hokuriku Bank responded that it did not retain signatory cards or ownership information for the 30 accounts and had to identify and contact each of its branches where the 30 accounts were opened, which would take time.<sup>1533</sup>

<sup>1528</sup> Id.

<sup>1529</sup> Email exchange among HBUS personnel, from Nov. to Dec. 2008, “Hokuriku Bank,” OCC-PSI-00811358, at 10-13. SK Trading Company was one of the 30.

<sup>1530</sup> Id. at 9-10.

<sup>1531</sup> Id. at 9.

<sup>1532</sup> Id. at 8.

<sup>1533</sup> Id. at 6.

On December 15, 2008, Ms. Kobayashi sent an email to multiple HBUS AML personnel forwarding additional questions from Hokuriku Bank about the new request for information.<sup>1534</sup> She also wrote:

“Please be advised that apparently they are not very happy with your request as they have other matters to attend toward the end of the year. ... Hokuriku Bank is not saying that they will not assist you to provide the required information however they are upset with the nature of the request without being given sufficient background. Given the nature of the queries, please understand it is time consuming and consider to allow them more time. They might not be able to supply the information by the end of the year.”<sup>1535</sup>

Two days later, Denis O’Brien, head of HBUS Global Transaction Banking Compliance, sent an email answering the questions posed by Hokuriku Bank.<sup>1536</sup> Later that same day, the HSBC Money Laundering Control Officer in Japan, Shinji Kawamura, sent an email to Mr. O’Brien indicating that Hokuriku Bank would not provide the requested information. He wrote:

“They have been good enough to provide information so far but as you may understand from bank secrecy viewpoint, they should not or cannot disclose customer information. So they will no longer provide information. If you need my suggestion to clear those backlogs, I will tell you that you should file suspicious transaction report to your authority.”<sup>1537</sup>

Notwithstanding that communication, two days later, on December 19, 2008, Ms. Kobayashi sent Mr. O’Brien an email stating that Hokuriku Bank “has provided the information at their risk and confirmed that the purchasers of the travelers checks ... are not signers or are NOT connected in any way to the previously requested named relationships at Hokuriku Bank. This should be the last favour and we cannot expect further or next assistance from them.”<sup>1538</sup>

Mr. O’Brien responded: “We are appreciative of your assistance and thank you for your diligence in this regard. We have closed our investigation as it related to this issue.”<sup>1539</sup>

The Subcommittee contacted Hokuriku Bank to learn more about the travelers cheques. The bank provided this additional information:

<sup>1534</sup> Id. at 4-5.

<sup>1535</sup> Id. at 5.

<sup>1536</sup> Id. at 3-4.

<sup>1537</sup> Id. at 2.

<sup>1538</sup> Id. at 1.

<sup>1539</sup> Id. at 1.



“Due to the geographic proximity of Russia across the Sea of Japan, many Japanese dealers of pre-owned automobiles are located along the coast, including the Hokuriku region. (Hokuriku means ‘North Land’ in Japanese.) Hokuriku Bank is headquartered in this area and has several branches in the surrounding areas. Some of such dealers have accounts at Hokuriku Bank.

In a typical transaction, a customer of Hokuriku Bank (that is to say an account holder) sells a used car (or cars) to a Russian buyer who is a passenger or crew member of a ship at a nearby port. The buyer pays with travelers’ checks. The seller/account holder brings the travelers’ cheques to its bank (Hokuriku) and deposits them into its account. Hokuriku Bank accepts the travelers’ checks, credits the customer’s account, and sends the checks to clearing banks.”<sup>1540</sup>

This description, which seems to describe a thriving used car business in northern Japan, does not explain why a single individual in Russia was using five individuals to purchase millions of dollars of sequentially numbered U.S. dollar travelers cheques from the same bank in Russia per month, and then signing and countersigning all of them. Nor does it explain why the parties were using U.S. dollars to purchase used cars located in Japan or why the Hokuriku branches had so little information about the 30 clients carrying in U.S. dollar travelers cheques totaling about \$500,000 to \$600,000 each day.

In February 2009, HBUS closed one of the accounts held by Hokuriku Bank, Account No. 50385, and transferred its balance to Account No. 34738. HBUS has not explained why it closed one account but not the other, or why Account No. 34738 was kept open when it was the subject of the extended HBUS inquiries to Hokuriku Bank in 2008. Because the one account remained open, the correspondent relationship between HBUS and Hokuriku Bank continued.<sup>1541</sup> The OCC examiners told the Subcommittee that they had thought all of the Hokuriku accounts had been closed in 2008, and were unaware of the ongoing relationship for some time.<sup>1542</sup>

<sup>1540</sup> 6/26/2012 letter from Hokuriku Bank’s legal counsel to the Subcommittee, at 4, PSI-HokurikuBank-01-0001.

<sup>1541</sup> HBUS KYC Profile of Hokuriku Bank, at HSBC-PSI-PROD-0102415, 420.

<sup>1542</sup> Subcommittee interviews of Joseph Boss (1/30/2012) and Elsa de la Garza (1/9/2012); 5/15/2012 email from OCC to the Subcommittee, “HSBC – Hokuriku Questions,” PSI-OCC-38-0001-002.

## I. 2010 OCC Discovery of Hokuriku Account Activity

Two years later, in the summer of 2010, two OCC AML examiners conducted a review of RDC services at the HBUS Buffalo processing center, including RDC processing of monetary instruments presented for deposit through electronic images.<sup>1543</sup> During that review, one of the examiners was surprised to discover that the Hokuriku account was not only still open, but that HBUS was processing monetary instruments for Hokuriku Bank through RDC.<sup>1544</sup> In an email to the OCC Examiner-in-Charge summarizing the RDC concerns that were communicated to HBUS after the examination field work, the examiner included: “Concern related to pouch activity being conducted by HSBC for Hokuriku.”<sup>1545</sup> He informed the Subcommittee that the volume of activity was “significant, but not as extensive as in 2008.”<sup>1546</sup>

In October 2010, a draft OCC Supervisory Letter detailing AML deficiencies in HBUS’ RDC operations specifically identified concerns related to Hokuriku Bank. After describing the problems uncovered in 2008, involving the bulk processing of Hokuriku travelers cheques, the letter stated:

“[I]n late 2008, early 2009, bank management informed the OCC that it would terminate the account relationship with Hokuriku. During the OCC’s RDC review, it was again found that pouch activity was being conducted by HSBC for Hokuriku. Upon further review, it was determined that at the time that the Bank was to have initially severed its relationship with Hokuriku, there existed two separate accounts for Hokuriku. At that time, management decided to close the account in which the aforementioned deposits [of travelers cheques] were being processed and continue to maintain the other account. It was through the second account that the pouch activity continued.”<sup>1547</sup>

The draft OCC letter also recited a long list of AML concerns involving the bank’s pouch activity. The final version of this Supervisory Letter included most of the information in the draft, but dropped the paragraph that singled out Hokuriku Bank.<sup>1548</sup> OCC personnel asked about the letter were unable to remember why the reference to Hokuriku Bank had

<sup>1543</sup> See 10/4/2010 draft Supervisory Letter from OCC to HBUS, OCC-PSI-00863984-992.

<sup>1544</sup> See 9/3/2010 email from OCC Joseph Boss to OCC Sally Belshaw and others, OCC-PSI-00887684-685. HBUS KYC Profile at HSBC-PSI-PROD-0102421; 5/15/2012 email from OCC to the Subcommittee, “HSBC – Hokuriku Questions,” PSI-OCC-38-0001-002.

<sup>1545</sup> 9/3/2010 email from OCC Joseph Boss to OCC Sally Belshaw and others, OCC-PSI-00887684-685.

<sup>1546</sup> 5/15/2012 email from OCC to the Subcommittee, “HSBC – Hokuriku Questions,” PSI-OCC-38-0001-002.

<sup>1547</sup> 10/4/2010 draft Supervisory Letter from OCC to HBUS, at OCC-PSI-00863990.

<sup>1548</sup> 10/21/2010 Supervisory Letter HSBC-2010-24 from OCC to HBUS, OCC-PSI-00880181-185.

been dropped.<sup>1549</sup> HBUS' legal counsel told the Subcommittee that HBUS stopped processing travelers cheques through the Hokuriku account in 2008.<sup>1550</sup> Hokuriku Bank similarly informed the Subcommittee that HBUS stopped processing its travelers cheques in October 2008.<sup>1551</sup>

The HBUS KYC Profile of Hokuriku Bank, updated in 2010, referenced ongoing AML concerns related to the bank, perhaps due to the OCC's renewed interest in the relationship. Among other matters, the KYC Profile indicated that, as of September 2010, despite a relationship of many years, HBUS did not have a copy on file of Hokuriku's KYC or AML policies and procedures.<sup>1552</sup> The profile also indicated that HBUS had sent an AML questionnaire to the bank, but Hokuriku Bank had not yet returned it. HBUS also noted in the 2010 profile that Hokuriku Bank did not have an independent AML compliance function within the bank, raising further questions about Hokuriku's AML efforts.<sup>1553</sup>

In May 2012, HBUS closed the Hokuriku Bank account.<sup>1554</sup> While that action ended the direct relationship, Hokuriku Bank still has correspondent relationships with other HSBC affiliates which, in turn, have correspondent accounts at HBUS. Accordingly, it is still possible for Hokuriku Bank to obtain U.S. dollar services through the U.S. dollar correspondent accounts of the HSBC affiliates, although Hokuriku Bank told the Subcommittee it is not doing so.

## J. Analysis

As a major global bank, HBUS serves as a gateway for foreign banks to obtain U.S. dollars, including through the clearing of U.S. dollar travelers cheques. HBUS AML Compliance personnel knew that travelers cheques were vulnerable to money laundering abuses, and that large numbers of sequentially numbered travelers cheques were a red flag. In 2003, it set up a data system that captured travelers cheque information, but in five years, appeared not to use it to identify suspicious activity or high risk clients. In 2007, the OCC found that HBUS essentially had no effective AML controls over the process used to cash travelers cheques and required the bank to strengthen its policies and procedures.

<sup>1549</sup> Subcommittee interview of Teresa Tabor (5/17/2012).

<sup>1550</sup> Subcommittee briefing by HSBC legal counsel (5/9/2012).

<sup>1551</sup> 6/26/2012 letter from Hokuriku Bank's legal counsel to the Subcommittee, PSI-HokurikuBank-01-0001-016, at 001.

<sup>1552</sup> HBUS KYC Profile at HSBC-PSI-PROD-0102421.

<sup>1553</sup> Id.

<sup>1554</sup> 6/26/2012 letter from Hokuriku Bank's legal counsel to the Subcommittee, at 1, PSI-HokurikuBank-01-0001.

The Hokuriku Bank example illustrates the problem. For years, Hokuriku Bank routinely presented a large volume of travelers cheques to HBUS for processing. Most involved sequentially numbered cheques signed and countersigned illegibly by the same person. For years, HBUS cleared the cheques with few questions asked. The cheque volume, which involved \$500,000 to \$600,000 in travelers cheques per day and \$70 to \$90 million per year, produced a four-year total of more than \$290 million. When directed by OCC to look into the transactions, HBUS quickly discovered that most of the cheques were being purchased for cash by Russians at a Russian bank and sent to Hokuriku Bank accounts in Japan. HSBC discovered that Hokuriku Bank had virtually no information about a network of 30, possibly related, accountholders who were physically turning in large stacks of sequentially numbered U.S. dollar travelers cheques to the bank every day. When asked about the accounts by HBUS, Hokuriku Bank resisted finding out and claimed bank secrecy requirements prevented it from disclosing client-specific information. HBUS also learned it was the only bank cashing the Hokuriku travelers cheques. Later, in 2010, HBUS discovered that Hokuriku Bank had no separate AML compliance function and was left waiting to receive a copy of its written AML policies and procedures. After the Subcommittee inquired about the account, HBUS closed it, although other HSBC affiliates are continuing to service the bank.

HBUS enabled a number of Russians engaged in suspicious activity to use a relatively small Japanese bank with weak AML controls to gain access to over \$290 million in U.S. dollars in less than four years. HBUS continued to clear the travelers cheques even after it learned of the transactions' suspicious nature. In so doing, HBUS facilitated the suspicious transactions and failed to live up to its AML obligations, all in return for about \$47,000 in annual revenues.

## **VII. HBUS PRIVATE BANK AMERICAS: OFFERING BEARER SHARE ACCOUNTS**

Over the course of a decade, HBUS allowed over 2,000 customers to open accounts in the name of bearer share corporations, a type of corporation that allows secrecy by assigning ownership to whomever has physical possession of the shares. At its peak, the Miami office had over 1,670 bearer share accounts; the New York office had over 850; and the Los Angeles office had over 30. The Miami bearer share accounts alone held assets totaling an estimated \$2.6 billion, generating annual bank revenues of \$26 million. Multiple internal audits and regulatory examinations criticized the accounts as high risk and advocated that HBUS either take physical custody of the shares or require the corporations to register the shares in the names of the shareholders.

In 2007, HBUS Compliance circulated a draft to standardize bearer share AML safeguards across the bank, including by designating all of the bearer share accounts as high risk clients requiring enhanced due diligence and monitoring. Internal documents show Miami and New York bank personnel successfully weakened the standards by enabling the majority of accounts not to be treated as high risk and requiring updated ownership information only once every three years. Later, HBUS learned that the British Virgin Islands (BVI), which formed most of the bearer share corporations with HBUS accounts, was requiring the registration of all outstanding BVI bearer shares by the end of 2009. In response, HBUS initiated an effort to require its BVI accountholders to register their shares by the legal deadline. In 2010, HBUS also contacted its other bearer share accountholders, requiring them either to register their shares or place their shares in the custody of HBUS or a third party. HBUS ended up obtaining registered shares or share custody for 1,155 accounts, closed over 530 accounts, and by 2012, had substantially reduced the number of bearer share accounts it maintained to 26.

Two examples of the accounts illustrate the risks they pose. In the first, two Miami Beach hotel developers, Mauricio Cohen Assor and Leon Cohen Levy, a father and son, used bearer share accounts they opened for Blue Ocean Finance Ltd. and Whitebury Shipping Time-Sharing Ltd. to help hide \$150 million in assets and \$49 million in income. In 2010, both were convicted of criminal tax fraud and filing false tax returns, sentenced to ten years in prison, and ordered to pay back taxes, interest, and penalties of more than \$17 million. A second example involves two Panamanian bearer share corporations, Urigeler International S.A. - Holding Company and Birmingham Merchant S.A. - Holding Company, beneficially owned by a wealthy and politically powerful family in Peru. The family sought a waiver from HBUS' AML requirements to avoid registering their shares or placing them in bank custody. When asked whether the waiver was granted when the account

was opened in 2007, HBUS legal counsel told the Subcommittee that “we don’t know.” The account was closed in 2011. These accounts demonstrate the risks associated with bearer share accounts, whose owners seek to hide their identities. Today, HBUS has 26 bearer share accounts left, most of which are frozen, but also maintains a policy allowing the bank to open more bearer share accounts in the future.

#### **A. High Risk Corporate Accounts**

Bearer share accounts have long been viewed as being at high risk for money laundering, due to the ability of bearer shares to hide ownership of a corporation. A 2005 U.S. Money Laundering Assessment defined bearer shares as follows:

“Bearer shares are negotiable instruments that accord ownership of a company to the person who possesses the share certificate. Such share certificates do not contain the name of the shareholder and are not registered, with the possible exception of their serial numbers. Accordingly, these shares provide for a high level of anonymity and are easily negotiable.”<sup>1555</sup>

Because of the ease of transfer and secrecy attached to bearer share corporations as well as their attractiveness to money launderers and terrorist financiers, their propensity for misuse have made them lose favor with governments and AML organizations.

**Financial Action Task Force.** The Financial Action Task Force (FATF) is the leading international AML body.<sup>1556</sup> In its 2006 report, “The Misuse of Corporate Vehicles, Including Trust and Company Service Providers,” FATF highlighted the AML problems associated with bearer share corporations. FATF explained that anonymity is a critical factor in facilitating the misuse of corporate vehicles, and bearer shares present a “special challenge to determining beneficial ownership of a corporate vehicle” because these shares “can be easily transferred without leaving a paper trail.”<sup>1557</sup> The FATF report noted that, while bearer shares can be used for legitimate purposes, they were also used for “money laundering, self-dealing, and/or insider trading.”<sup>1558</sup>

<sup>1555</sup> 12/2005 “U.S. Money Laundering Threat Assessment,” issued by the Money Laundering Threat Assessment Working Group, which included the U.S. Departments of Treasury, Justice, and Homeland Security, Federal Reserve, and Postal Service, <http://www.justice.gov/dea/pubs/pressrel/011106.pdf>, at 47.

<sup>1556</sup> See FATF website, [www.fatf-gafi.org](http://www.fatf-gafi.org).

<sup>1557</sup> 10/13/2006 “The Misuse of Corporate Vehicles, Including Trust and Company Service Providers,” at 10, FATF Publication, <http://www.fatf-gafi.org/media/fatf/documents/reports/Misuse%20of%20Corporate%20Vehicles%20including%20Trusts%20and%20Company%20Services%20Providers.pdf>

<sup>1558</sup> Id. at 16.

**Organisation for Economic Co-operation and Development.**

The Organisation for Economic Co-operation and Development (OECD) is a 50-year-old membership organization of 34 countries including the United States, which tackles issues of common interest to promote economic development.<sup>1559</sup> In a 2001 report, "Behind the Corporate Veil," the OECD identified bearer shares as one of the primary means used to achieve anonymity for the beneficial owners of corporations. The OECD report noted that bearer shares' high level of anonymity and ease of transfer "make them attractive for nefarious purposes, such as money laundering, tax evasion, and other illicit conduct, especially when they are issued by private limited companies."<sup>1560</sup> The OECD noted that bearer shares were especially vulnerable to misuse, because of the lack of information available to authorities in the event of an investigation.<sup>1561</sup>

**U.S. Government.** The United States has also criticized bearer share corporations. In 2005, for example, multiple U.S. agencies worked together to produce a U.S. Money Laundering Threat Assessment to identify key money laundering methods.<sup>1562</sup> The Assessment identified the use of shell corporations as a key AML problem and singled out bearer shares as one of the means, along with nominee shareholders and directors, "to mask ownership in a corporate entity."<sup>1563</sup> It warned that bearer shares "provide money launderers with the tools to hide their identity from financial institutions and law enforcement."<sup>1564</sup> In addition, Federal financial regulators warn about the risks associated with bearer shares, because they allow "ownership of the corporation to be conveyed by simply transferring physical possession of the shares."<sup>1565</sup> The Federal regulators' joint AML examination manual states that due to the risk, "in most cases banks should choose to maintain (or have an independent third party maintain) bearer shares for customers."<sup>1566</sup>

**World Bank.** A 2011 report issued by the World Bank on corporate transparency issues is a recent example of an international

<sup>1559</sup> See OECD website, [www.oecd.org](http://www.oecd.org).

<sup>1560</sup> "Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes," OECD publication, at 30, <http://www.oecd.org/dataoecd/0/3/43703185.pdf>.

<sup>1561</sup> Id.

<sup>1562</sup> See 12/2005 "U.S. Money Laundering Threat Assessment," issued by the Money Laundering Threat Assessment Working Group, which included the U.S. Departments of Treasury, Justice, and Homeland Security, Federal Reserve, and Postal Service, <http://www.justice.gov/dea/pubs/pressrel/011106.pdf>.

<sup>1563</sup> Id. at 47.

<sup>1564</sup> Id. at 48.

<sup>1565</sup> 4/29/2010 "BSA/AML Examination Manual," Federal Financial Institutions Examination Council, "Bearer Shares," at 282,

[http://www.ffiec.gov/bsa\\_aml\\_infobase/documents/BSA\\_AML\\_Man\\_2010.pdf](http://www.ffiec.gov/bsa_aml_infobase/documents/BSA_AML_Man_2010.pdf).

<sup>1566</sup> Id. The AML examination manual also stated: "In rare cases involving lower-risk, well-known, long-time customers, banks may find that periodically re-certifying beneficial ownership is effective." Id.

body condemning use of bearer share corporations. It indicates that, in recent years, bearer share corporations have “generally been frozen out of the financial sector,” asserts that “[n]o bank with any sort of due diligence standards is willing to conduct business with a company that has free-floating bearer shares,” but also states that such corporations remain an AML threat:

“Concerns have been raised in AML forums that companies that issue bearer shares are used extensively for illegal activities, such as tax evasion and money laundering .... In most jurisdictions, bearer-share statutes have generally been undergoing a process of reform and elimination ....

Financial compliance officers and company service providers report that bearer shares have generally been frozen out of the financial sector even if they are still permitted by the laws of a particular jurisdiction. No bank with any sort of due diligence standards is willing to conduct business with a company that has free-floating bearer shares. Companies that are not required under their own laws to have bearer shares immobilized will typically have to place the share in the trust of an agent of the bank, as a condition of being accepted as a customer. ...

Given the legislative reforms of the past decade and the fact that bearer shares or share warrants featured in roughly 1 percent of the grand corruption cases we reviewed, one might be inclined to consider bearer securities to be a problem of the past. Investigators interviewed for this study from Latin America and the Caribbean disagree, however. They maintain that bearer-share companies are still a problem for money laundering investigations, that their anonymity prevents detection and impedes prosecution, and that corrupt individuals still can gain access to financial systems and undertake anonymous transactions involving considerable sums.

In practice, there is scant business rationale for the continued use of bearer securities. The claims that bearer securities are necessary to facilitate transfer of ownership and enhance liquidity no longer hold for the vast majority of countries. An electronic system of registered shares is clearly a more efficient platform for transferring equity interests. In this case, the risks outweigh the benefits.”<sup>1567</sup>

<sup>1567</sup> “Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It,” World Bank (2011), at 41, 43-44.



## B. Bearer Share Activity at HBUS

Despite the widespread, longstanding international condemnation of bearer share corporations, until last year, HBUS maintained hundreds, sometimes thousands, of bearer share accounts in the United States. At its peak, HBUS had over 2,000 bearer share accounts, including 1,667 accounts at the International Private Bank in Miami,<sup>1568</sup> 851 at the International Private Bank in New York;<sup>1569</sup> and 33 at the International Private Bank in Los Angeles.<sup>1570</sup> The Miami bearer share accounts alone have held assets totaling an estimated \$2.6 billion and produced revenues to the bank of \$26 million per year.<sup>1571</sup>

These accounts were overseen by two different Federal banking regulators. The OCC oversaw the accounts in New York and Los Angeles, which were held in the HBUS International Private Banking division. The bearer share accounts in Miami, however, were lodged with a different HBUS subsidiary, which was often called an International Private Bank, but was actually formed under the Edge Act, a Federal law which allows corporations to be chartered by the Federal Reserve, engage solely in international banking, and serve only non-U.S. citizens with U.S. banking needs.<sup>1572</sup> Edge Act corporations are regulated by the Federal Reserve.<sup>1573</sup> The Miami bearer share accounts were accordingly overseen by the Federal Reserve Bank of Atlanta which conducted an annual examination of its operations.<sup>1574</sup>

HBUS' bearer share accounts repeatedly raised AML concerns largely because the accounts suffered from missing or inadequate KYC information. A 2004 internal audit of HBUS' Private Bank International in Miami by HSBC Group auditors found, for example, that sixty bearer share accounts lacked "Certificates of Beneficial Owner" forms,

<sup>1568</sup> See 10/2007 "HSBC Group Financial Services and European Audit Report on HSBC Private Bank International, Miami and HBUS Domestic Private Banking-Florida Region," OCC-PSI-00223637 (citing 1,667 accounts in October 2007); 12/11/2007 email from HBUS Jeff Clous to HBUS Paul O'Sullivan and others, "Bearer Share Corporation Policy," OCC-PSI-00226652 (citing 1,679 accounts in December 2007); but see OCC-PSI-00217164 (estimating 600 accounts in July 2007).

<sup>1569</sup> See 10/2007 "HSBC Group Financial Services and European Audit Report on HSBC Private Bank International, Miami and HBUS Domestic Private Banking-Florida Region," OCC-PSI-00223637 (citing 851 accounts in November 2005); see 8/27/2007 email from Alan Williamson to Terry Westren, OCC-PSI-00318438, with accompanying 2007 List of New York Bearer Share Accounts, OCC-PSI-00318439 (citing 636 accounts in August 2007).

<sup>1570</sup> 11/11/2005 memorandum from OCC C. Seiler, "Bearer Share Activity," at 2, OCC-PSI-01437596 (citing 33 accounts in November 2005).

<sup>1571</sup> 12/11/2007 email from HBUS Jeff Clous to HBUS Paul O'Sullivan, "Bearer Share Corporation Policy," OCC-PSI-00226652.

<sup>1572</sup> See 6/12/2008 letter from FRB of Atlanta Robert Schenck to HSBC Private Bank International Board of Directors, OCC-PSI-00107444-449; Section 25A of the Federal Reserve Act, P.L. 102-242, codified at 12 U.S.C. §§611-631.

<sup>1573</sup> Section 25A of the Federal Reserve Act, P.L. 102-242, codified at 12 U.S.C. §§611-631.

<sup>1574</sup> The Miami Edge Act corporation has undergone annual Federal Reserve audits since at least 2006.

meaning the bank had no information on who owned the accounts. The audit also repeated a recommendation carried forward from a 2002 Group Audit that management should obtain the missing beneficial ownership information “at the earliest opportunity,”<sup>1575</sup> suggesting the ownership information had been missing for at least two years. In February 2005, an HBUS Monthly Private Banking Compliance Report to HSBC Group noted that ten bearer share accounts had been frozen due to missing “Beneficial Ownership Letters,” and Relationship Managers for the accounts had been notified they had 30 days to obtain the needed documents or the accounts would be closed.<sup>1576</sup>

**OCC Concern.** In 2005, the OCC identified the HBUS bearer share accounts as an AML concern and, in 2006, directed HBUS to assess their AML risk and take physical control of the bearer shares.

In November 2005, the OCC conducted an AML examination of HBUS’ International Private Banking division and looked at the bearer share accounts in its New York and Los Angeles offices. In November 2005, an OCC AML examiner wrote an internal memorandum summarizing HBUS’ “Bearer Share Activity” and recommending that HSBC adopt a policy to “ensure that either the bank or an acceptable third party controls the bearer shares.”<sup>1577</sup> The memorandum stated that the HBUS New York office then had 851 bearer share accounts and the California office had 33.<sup>1578</sup> The memorandum explicitly noted the AML risks attached to the bearer share accounts and the need to obtain satisfactory evidence of the accounts’ beneficial owners. It noted that bearer share certificates allowed corporate ownership to be transferred without the bank’s knowledge, and OCC policy was to require banks to maintain control of all bearer shares.<sup>1579</sup> The memorandum also discussed new legislation in the British Virgin Islands that “provides a legal framework for immobilizing bearer shares.”<sup>1580</sup>

As a result of the AML examination, on January 31, 2006, the OCC issued a Supervisory Letter to HBUS which included a Matter

<sup>1575</sup> 2/2004 Group Financial Services Audit Report on High Level Controls Review of HSBC Private Bank International, at 5, OCC-PSI-00210878.

<sup>1576</sup> 3/7/2005 report from HSBC Carolyn Wind and HSBC Teresa Pesce to HSBC Curt Cunningham and HSBC Anthony Gibbs, “Monthly Private Banking Compliance Report for February 2005,” HSBC OCC 7695260-266.

<sup>1577</sup> 11/11/2005 OCC memorandum, “Bearer Share Activity,” OCC-PSI-01437596. According to the memorandum, the policy at the time was that the International Private Bank required the following for each bearer share account: an explanation for opening the account, CEO approval, and completion of a beneficial ownership letter, to be certified every 3 years, identifying the beneficial owners of the bearer share company.

<sup>1578</sup> *Id.*

<sup>1579</sup> *Id.*

<sup>1580</sup> *Id.* (explaining that, under the BVI legislation, international corporations formed after January 1, 2005 would have to have their shares held by either an “authorized” or “recognized” custodian. Companies formed prior to January 1, 2005, would have a transition period in which to either have the shares registered or have them held by a custodian).

Requiring Attention (MRA) of the HBUS Board of Directors directing HBUS to strengthen AML controls over its bearer share accounts.<sup>1581</sup> The Supervisory Letter stated:

“Management should evaluate the risks associated with bearer share accounts. BSA/AML policy and procedures need to be revised to ensure that either the bank or an acceptable third party controls the bearer shares. The bank must monitor legal requirements in countries that allow for the organization of International Business Companies (IBCs) and Private Investment Companies (PIC). Policies and procedures need to define ‘acceptable third parties’ and any applicable due diligence, and specify documentation required by the bank to ensure that the shares have been properly received by the third party custodian.”<sup>1582</sup>

The Supervisory Letter also stated that HBUS management had “agreed to implement revised policies and procedures for bearer shares in accordance with our recommendation by March 31, 2006.”<sup>1583</sup> When asked about this Supervisory Letter, the OCC Examiner-in-Charge at HBUS, Anthony DiLorenzo, did not remember the bearer share issue, but said that, aside from HSBC, he had not seen bearer share accounts at other large banks that he oversaw.<sup>1584</sup>

On March 3, 2006, HBUS responded to the Supervisory Letter with a proposal that did not completely follow the OCC instruction on bearer shares. Instead of requiring that all bearer share certificates be placed in custody for all of its bearer share accounts, HBUS indicated that it would require custodization only for what it deemed to be high risk bearer share accounts. For lower risk bearer share accounts, HBUS would not take possession of the shares, but would allow accountholders to submit to the bank a “beneficial ownership letter” every two years stating who had possession of the corporate shares. HBUS committed to having a plan in place to implement this approach by March 31, 2006.<sup>1585</sup>

At the same time the OCC was reviewing the New York and Los Angeles bearer share accounts, the Federal Reserve was performing a “risk-focused examination” of the Edge Act subsidiary holding the Miami accounts, HSBC Private Banking International. In January 2006, the Federal Reserve issued a Report of Examination (ROE) deeming the

<sup>1581</sup> 1/31/2006 OCC Supervisory Letter, “International Private Banking BSA/AML Examination,” OCC-PSI-00000317. [Sealed Exhibit.]

<sup>1582</sup> Id. at 3.

<sup>1583</sup> Id.

<sup>1584</sup> Subcommittee interview of Anthony DiLorenzo (3/22/2012).

<sup>1585</sup> 3/3/2006 letter HSBC Teresa Pesce to OCC Anthony DiLorenzo, “International Private Banking BSA/AML Examination,” at 2, OCC-PSI-01358804-809.

overall risk management framework for the Miami operation as satisfactory, while identifying as its “primary risk” the “reputational risk, arising from its international private banking and wealth management activities that are directed towards a high net-worth Latin American client base.”<sup>1586</sup> The ROE also deemed the Miami office’s AML program as adequate, while noting numerous issues involving offshore accounts, unavailable offshore documentation, offshore shell companies “serving as operating accounts,” and the addition of international private banking accounts moved from New York which added “in excess of \$1 billion” to the assets under management in Miami, but made no mention of bearer share accounts.<sup>1587</sup>

In February 2006, as the OCC deadline approached for implementing stronger AML controls over HBUS’ bearer share accounts, the head of HBUS’ International Private Bank (IPB) Operations in Miami, Jeff Clous, asked a Miami law firm prepared an analysis for the bank on the Federal Reserve’s policy regarding bearer share accounts. According to Mr. Clous, the law firm reported that the Federal Reserve expected banks to conduct a risk assessment and assign risk classifications to each account for risk-based monitoring. According to Mr. Clous, the law firm also informed him that the Federal Reserve provided banks with the option of either obtaining custody of the bearer shares or recertifying beneficial ownership of the shares on a periodic basis, based upon the account’s risk classification.<sup>1588</sup>

Mr. Clous emailed his report of the law firm’s analysis to senior personnel in the New York International Private Bank (IPB), the CEO of Private Bank America, Philip Musacchio, the Chief AML Officer of Private Bank, Susan Hoggarth, and the Head of Private Bank Operations Terry Westren. Mr. Musacchio responded that New York would prefer to adopt this “much better and reasonable approach.”<sup>1589</sup> Ms. Hoggarth replied:

“That may work for Miami, but it won’t work for the OCC in NY and California. The OCC has specifically advised us that the Beneficial Ownership letters are not sufficient. We have been advised that the shares need to be held either by ourselves or an accepted third party.”<sup>1590</sup>

<sup>1586</sup> 1/19/2006 letter from FRB Atlanta to HSBC Private Bank International Board of Directors, OCC-PSI-00309434. [Scaled Exhibit.]

<sup>1587</sup> Id. at 2, 4-6.

<sup>1588</sup> 2/9/2006 email exchanges among HBUS Susan Hogart, HBUS Philip Musacchio, HBUS Jeff Clous, HBUS Teresa Pesce, and HBUS Terry Westren, “Bearer Shares – More Info,” HSBC OCC 4816460-462.

<sup>1589</sup> Id.

<sup>1590</sup> Id.

Mr. Musacchio responded that he had assumed that Ms. Hoggarth would explain the Federal Reserve's position to persuade the OCC to agree to the same approach.<sup>1591</sup> Ms. Hoggarth replied that the OCC examiners had already advised the bank that beneficial ownership letters were not adequate, and she did not think the OCC would accept the Federal Reserve's approach.<sup>1592</sup>

When the OCC's bearer share deadline arrived at the end of March 2006, however, little had changed in either the New York or Miami IPB offices. Both continued their policy of obtaining periodic beneficial ownership letters from most accounts, and arranging for shares to be taken into custody only for a small percentage of accounts deemed to be higher risk.

The documents reviewed by the Subcommittee also contain no indication that the OCC followed up with HBUS on the bearer share MRA in the 2006 OCC Supervisory Letter. When asked why, the OCC AML Examiner told the Subcommittee that he had been informed by HBUS that it had closed all of its bearer share accounts in 2006, and didn't learn until 2010, that the bearer share accounts had, in fact, remained open.<sup>1593</sup>

**Proposed Job Aid on Bearer Shares.** From at least 2002 to 2007, HBUS did not have a standard policy establishing how its various branches should handle bearer share issues and what AML safeguards should be used.<sup>1594</sup> In early 2007, HBUS undertook an effort to develop a standard bearer share policy that would apply to all HBUS offices. It was an effort that would take the rest of the year.

An HBUS AML Compliance officer located in New York, Ali Kazmy, was tasked with developing the policy. In February 2007, he emailed his supervisor, Mary Caskin, that he hoped to finalize a draft that week.<sup>1595</sup> Internal documents indicate that, a few months later, the draft was circulated to other HBUS Compliance personnel for comment. At least one colleague sought to strengthen it. On April 17, 2007, HBUS AML Compliance officer Robert Guthmuller sent an email to colleagues stating that the policy should not make it optional for bearer shares to be classified as high risk. Mr. Guthmuller contended that approach did not mirror other banks' policies: "For at least the last 10

<sup>1591</sup> Id.

<sup>1592</sup> Id.

<sup>1593</sup> See 5/10/2010 email exchanges among OCC Joseph Boss, Lee Straus, James Vivencio, Monica Freas, Sally Belshaw, and others, "Bearer Share Accounts" OCC-PSI-00886601 (discussed further *supra*).

<sup>1594</sup> See 2/26/2007 email exchanges among HBUS Ali Kazmy and HBUS Mary Caskin and others, "APC Interim Procedures," OCC-PSI-00307701 ("At present, we do not have a standard bearer share policy. I am actually working on it and expect it to be finalized this week, however it will require senior management approval.").

<sup>1595</sup> Id.

years, all private banks I know classify ALL bearer share PICs as high risk.”<sup>1596</sup>

In June 2007, Mr. Kazmy sent a draft “Job Aid” on bearer shares to the IPB offices with bearer share accounts.<sup>1597</sup> HBUS Job Aids were documents designed to provide more specific instructions to bank personnel in implementing higher level policies and procedures.<sup>1598</sup> Mr. Kazmy immediately met strong resistance to strengthening the AML controls on bearer share accounts.

Teresa Garcia, who was a senior Compliance officer at the New York IPB, criticized the draft on several grounds: for requiring all bearer share accounts to be classified as SCC accounts subject to enhanced due diligence and monitoring; requiring all shares to be held in the custody of the bank; and requiring beneficial ownership to be disclosed every two years.<sup>1599</sup> Ms. Garcia wrote that, although the Job Aid was similar to an existing policy at the New York IPB, the New York IPB did not classify bearer share accounts as SCCs unless the nature of the beneficial owner warranted it, and bearer certificates could be held with a third party custodian instead of the bank. Ms. Garcia added that the Job Aid should only require beneficial ownership disclosure forms to be renewed every three years. Later that day, Ms. Garcia sent another email to Mr. Kazmy and others stating: “IPB-NY has about 500 non-high risk bearer share accounts. There is no way we are making all these accounts SCCs.”<sup>1600</sup> These emails, in which Ms. Garcia opposed the proposed AML controls, show that she saw her role in this instance as acting on behalf of the business unit rather than acting on behalf of HBUS Compliance.

The Miami office was also critical of the proposed Job Aid. Clara Hurtado, Director of AML Compliance for Miami, wrote:

“Miami also has a large number of bearer share accounts. I too disagree with making these SCCs. We are also getting an updated BOL [Beneficial Ownership Letter] every 3 years, not 2 years. Before anything goes out to the units, we need to be careful that we do not change the agreed upon policies/procedures which have been put in place based on local regulator requirements.”<sup>1601</sup>

<sup>1596</sup> 4/17/2007 email from HBUS Robert Guthmuller to HBUS Nerissa Hall and Alan Williamson, OCC-PSI-00211658.

<sup>1597</sup> 6/18/2007 email from HBUS Ali Kazmy to HBUS Anne Liddy, “Job Aid – Bearer Share,” OCC-PSI-00617514.

<sup>1598</sup> Subcommittee interview of Ali Kazmy (2/29/2012).

<sup>1599</sup> 6/18/2007 email from HBUS Ali Kazmy to HBUS Anne Liddy, “Job Aid – Bearer Share,” OCC-PSI-00617514.

<sup>1600</sup> Id.

<sup>1601</sup> Id.

On July 25, 2007, Ms. Hurtado sent Mr. Kazmy another email stating that Miami had approximately 600 bearer share accounts and they “could not possibly categorize them all as high risk.”<sup>1602</sup> She proposed instead that Miami use the bearer shares as one indicator of a high risk account, but that a second indicator would also have to be present before the account would be classified as high risk and subjected to enhanced due diligence and monitoring. She wrote: “We feel this is a good way to capture truly high risk bearer share accounts.” Ms. Hurtado also asserted that there was “no way to custodize in Miami and remotely was too difficult.”<sup>1603</sup> She proposed instead that Miami maintain its current practice of requiring a Beneficial Ownership Letter for new accounts with updates every three years. She noted that the Miami policy had just been approved by HBUS Compliance head Teresa Pesce and Compliance Officer of California Programs, Susan Hoggarth, both of whom had agreed that Miami would not have to custodize the shares.<sup>1604</sup> These emails show that Ms. Hurtado, like Ms. Garcia, saw her role in this instance as defending the position of the international private bank rather than the position of HBUS Compliance.

Four days later, on July 29, 2007, Ms. Hurtado sent Mr. Kazmy another email suggesting that the AML Director rather than the CEO should be able to approve the opening of bearer share accounts. She also wrote that the Miami subsidiary “will not be lowering the monitoring thresholds on over 600 bearer share accounts,” and that Miami’s use of Beneficial Ownership Letters had been approved by HBUS Corporate Compliance and the office “cannot go back and re-paper.”<sup>1605</sup> The next day, Ms. Hurtado forwarded Mr. Kazmy a copy of the Miami bearer share procedures, explaining that if he wanted to change them, he would need to “reach out to the business first,” and gave him contact information for Jeff Clous, head of HBUS IPB Operations in Florida.<sup>1606</sup>

On August 6, 2007, Mr. Kazmy forwarded Ms. Hurtado’s emails to two more senior HBUS AML Compliance officials, Alan Williamson and Anne Liddy. Though Mr. Williamson had agreed that IPB Miami should be included in the new policy, he said after reading Ms. Hurtado’s emails, “unfortunately I now question my prior inclination to make them be consistent.”<sup>1607</sup> Mr. Williamson suggested that the new guidance be prospective from the date of issuance so that the bank

<sup>1602</sup> 7/25/2007 email from HBUS Clara Hurtado to HBUS Ali Kazmy and others, “Bearer Share Meeting,” OCC-PSI-00217164.

<sup>1603</sup> Id.

<sup>1604</sup> Id.

<sup>1605</sup> Id.

<sup>1606</sup> 8/6/2007 email exchange among HBUS Ali Kazmy, HBUS Alan Williamson, HBUS Clara Hurtado, and others, “miami bearer share procedures,” OCC-PSI-00217163.

<sup>1607</sup> 8/9/2007 email exchanges among HBUS Ali Kazmy, HBUS Alan Williamson, and HBUS Anne Liddy, “On Boarding Bearer Share Corporation Policy Guidance,” OCC-PSI-00316956.

would not have to do a retrospective review of bearer share accounts, stating that “may be a good idea but we should avoid locking ourselves in.” Mr. Williamson also recommended adding an “exception process” in the policy, because there is “always a special case somewhere.”<sup>1608</sup> Mr. Kazmy replied that the bank may have to do a retrospective review over a reasonable time period, but agreed to include the following line in the policy: “Exceptions to this Policy must be sought from the AML Director or designee in writing giving full details of the matter warranting such exception. The written approval must be maintained in customer file and reported to Oversight & Control Group upon receipt.”<sup>1609</sup> In August 2007, the New York IPB policy for bearer shares was slightly strengthened. It required all new clients wishing to open a bearer share account to obtain approval from the New York IPB CEO and AML Local Compliance Officer, and further required them to register or custodize their shares.<sup>1610</sup> This policy essentially treated all new bearer share accounts as high risk, though no mention was made of enhanced due diligence or monitoring obligations. Existing bearer share accounts were kept divided into high and low risk accounts. High risk bearer share accounts were required to register or custodize their shares. Low risk bearer share accounts were allowed to provide a Beneficial Ownership Letter every three years, and their shares were not taken into custody.<sup>1611</sup> At this time, HBUS New York held over 630 bearer share accounts.<sup>1612</sup>

**American Express Prosecution.** On August 6, 2007, the U.S. Justice Department, working with the Federal Reserve and FinCEN, filed a Deferred Prosecution Agreement against American Express Bank International for criminal violations of Federal AML laws.<sup>1613</sup> In August 2007, HBUS Compliance circulated information about the prosecution,<sup>1614</sup> not because HBUS had participated in any of the matters involving American Express,<sup>1615</sup> but to alert employees to the prosecution, ascertain if any of the American Express clients were also clients of HBUS, and point out that the Deferred Prosecution Agreement had targeted the bank in part for lack of sufficient AML controls over bearer share accounts.<sup>1616</sup>

<sup>1608</sup> 8/6/2007 email exchanges among HBUS Ali Kazmy, HBUS Alan Williamson, and HBUS Anne Liddy, “On Boarding Bearer Share Corporation Policy Guidance,” OCC-PSI-00217148

<sup>1609</sup> Id.

<sup>1610</sup> 8/27/2007 email exchanges among HBUS Alan Williamson, HBUS Terry Westren, and others, “OCC-PSI-00318438

<sup>1611</sup> Id.

<sup>1612</sup> 2007 List of New York Bearer Share Accounts, OCC-PSI-00318439.

<sup>1613</sup> *United States v. American Express Bank International*, Case No. 07-20602-CR-ZLOCH/SNOW (USDC SD Flor.), Deferred Prosecution Agreement (8/7/2007).

<sup>1614</sup> 8/9/2007 email exchanges among HBUS Ali Kazmy, HBUS Alan Williamson, and HBUS Anne Liddy, “On Boarding Bearer Share Corporation Policy Guidance,” OCC-PSI-00316956.

<sup>1615</sup> 8/7/2007 email exchanges among OCC HBUS Daniel Jack, HBUS Alan Williamson, and others, “AML Enforcement Actions vs AmEx (Banknotes & Metals)” OCC-PSI-00217241.

<sup>1616</sup> 8/7/2007 email exchanges among HBUS Daniel Jack, HBUS Michael Baez, HSBC/IBEU Gordon Brown, HBMD Sally Lomas, HBUS Michael Karam, and others, “AML Enforcement



In response, on August 16, 2007, Jeff Clous, head of HBUS IPB Operations in Florida, expressed concern to Alan Williamson of HBUS Compliance about HBUS' relative dearth of AML compliance resources compared to American Express, which had twelve full time compliance staff. He wrote: "I believe we have resource constraints that impact our AML program that need to be addressed."<sup>1617</sup>

The next day, on August 17, 2007, HBUS Compliance head Carolyn Wind and Alan Williamson met with Federal Reserve officials. During this meeting, described by HBUS as "friendly," the Federal Reserve referenced the American Express case, suggested HBUS might have similar issues, and suggested the HBUS Miami management and compliance teams take another look at risky products, such as bearer share companies.<sup>1618</sup> In a summary of the meeting, Ms. Wind noted that one Federal Reserve employee commented with respect to HBUS: "if you take the facts from the American Express case and lay them over our last report of HSBC, they are all there."<sup>1619</sup> Earlier in the year, on January 24, 2007, the Federal Reserve had issued a Report of Examination for the Miami IPB which included a requirement that management "enhance the current controls over bearer share accounts to ensure that they are sufficiently risk-based and capable of detecting changes in ownership of these entities on an ongoing basis."<sup>1620</sup>

That same month, HBUS Compliance began conducting a "gap analysis" comparison of the American Express case versus its own AML program. On October 11, 2007, the analysis was issued and identified bearer shares as a particular concern at both American Express and HBUS.<sup>1621</sup> It also announced the decision by HBUS to stop opening new bearer share accounts as of September 1, 2007, and to consider also eliminating all of its existing bearer share accounts:

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Action against AmEx businesses," OCC-PSI-00153253. On August 9, 2007, Ali Kazmy wrote, "At this juncture, your cognizance is drawn to the recently issued enforcement action against American Express entities, who were penalized up to \$55 million for BSA/AML violations including those associated with PICS/bearer share accounts." 8/09/2007 email from Ali Kazmy to Alan Williamson, OCC-PSI-00316956.

<sup>1617</sup> 8/20/2007 email exchanges among HBUS Alan Williamson, HBUS Camillus Hughes, and others, "AEBI Deferred Prosecution Agreement," OCC-PSI-00218380.

<sup>1618</sup> 8/23/2007 email exchanges among HBUS Marlon Young, HBUS Carolyn Wind, HBUS Louis Marino, HBUS Jeff Clous, and others, "File Note on Meeting with Federal Reserve Bank of Atlanta," OCC-PSI-00698461.

<sup>1619</sup> Id.

<sup>1620</sup> 1/24/2004 Board of Governors of the Federal Reserve System "Report of Examination of Edge Corporation," OCC-PSI-00388110. 1/24/2004 Board of Governors of the Federal Reserve System "Report of Examination of Edge Corporation," OCC-PSI-00107432.

<sup>1621</sup> 10/11/2007 "High Level Comparison of Key Anti-Money Laundering Program Deficiencies Identified at American Express Bank international," prepared by Alan Williamson and Stefan Hardy, OCC-PSI-00221959.

“AEBI [American Express Bank International] failed to exercise sufficient control over accounts held in the names of **offshore bearer share corporations**, and until 2004 had no policy or procedure requiring beneficial owners of such accounts to certify in writing their continued ownership of the bearer shares.

***Bearer share accounts are known and HSBC requires written confirmation every three years. A decision has been taken by the business not to accept new bearer share accounts beginning 9/1/07. Management is considering a program to eliminate all bearer share customers.”***<sup>1622</sup>

Although HBUS announced a ban on opening new bearer share accounts as of September 1, 2007, it issued a new bank-wide bearer share policy three months later allowing new accounts.

**Final Bearer Shares Policy.** On December 10, 2007, HBUS Compliance officer Paul O’Sullivan circulated a final draft of the proposed new Bearer Share Policy. He explained that the policy was more flexible than first proposed, and “we will be able to maintain Bearer Share Company accounts once the requirements of the policy are met.”<sup>1623</sup> The draft policy applied to both new and existing bearer share accounts. It required all bearer share accounts to either register their shares or keep the shares in custody with the bank or an approved third party. In addition, Beneficial Ownership Letters would have to be filed every three years. The draft policy also permitted new accounts to be opened if they were approved by the Business Unit head, AML Local Compliance Officer, and AML Director, or a designee. The approvals would have to be documented and retained in the customer file.<sup>1624</sup>

On December 11, 2007, HBUS Compliance officer Terry Westren responded as follows:

“If I read this correctly, it is saying that one year from the issuance of this policy, we have to have all outstanding bearer shares (currently with clients), either registered or in the hands of an approved Custodian. Is this correct? I recall when the OCC was here, they asked for this. AML Compliance was able to negotiate for this requirement to be applicable only to High Risk accounts. We then complied with this. It looks like this is now expanded to all outstanding bearer shares? Of course, with the new BVI rules

<sup>1622</sup> Id. (Emphasis in original.)

<sup>1623</sup> 12/10/2007 email exchanges among HBUS Paul O’Sullivan, HBUS Terry Westren, HBUS Mason Salit, HBUS Tereso Suarez-Obregon, and others, “Bearer Share Corporation Policy,” OCC-PSI-00226525.

<sup>1624</sup> 8/29/2007 Bearer Share Corporation Account “Policy Guidance,” OCC-PSI-00226526.

coming into play in 2009, they will have to do this anyway, but I think it should be noted this could be a considerable exercise.”<sup>1625</sup>

Contrary to the statement in this email, however, the 2006 OCC Supervisory Letter had already called for the bank to place all bearer shares in the custody of either the bank or an acceptable third party, with no exceptions made for lower risk accounts.<sup>1626</sup> While HBUS had responded to the Supervisory Letter that it planned to limit that requirement to higher risk accounts, there is no documentation showing the OCC accepted that position. When asked about this email, the OCC told the Subcommittee it had been under the impression that HBUS had closed all of its bearer share accounts.<sup>1627</sup>

That same day, December 11, 2007, Jeff Clous, IPB Operations head in Florida, repeated the concerns he had voiced to Alan Williamson in September. Mr. Clous asserted that the draft policy would have an adverse effect on IPB business. He noted that, although IPB Miami was no longer opening new bearer share accounts, it still maintained 1,679 accounts with \$2.6 billion, which generated \$26 million in revenue annually. Mr. Clous also asserted that the draft policy went too far beyond what regulators required. He noted that the proposed policy required the bank to both register and custodize bearer share accounts, while the Federal AML examination manual offered a choice between those options. In addition, he noted that the draft policy would require existing bearer share accounts to register or custodize their shares by the end of 2008, even though the new BVI bearer share regulations would not require the registration of BVI bearer shares until the end of 2009.<sup>1628</sup>

On December 14, 2007, the HBUS Board of Directors approved its first HBUS-wide Bearer Share Policy.<sup>1629</sup> The bearer share policy applied to all new and existing bearer share accounts and required the client to register the shares or agree to hold the shares in custody with HSBC or a third party custodian and provide a periodic beneficial ownership certificate.<sup>1630</sup> AML Director Leslie Midzain gave both IPB New York and Miami IPB a full year, until 2009, to comply with the

<sup>1625</sup> 12/11/2007 email exchanges among HBUS Terry Westren, HBUS Paul O'Sullivan, and others, "Bearer Share Corporation Policy," OCC-PSI-00327917.

<sup>1626</sup> See 1/31/2006 OCC Supervisory Letter, "International Private Banking BSA/AML Examination," OCC-PSI-00000317. [Sealed Exhibit.]

<sup>1627</sup> Subcommittee interview of Joseph Boss (1/30/2012) and James Vivencio (3/15/2012). See also 5/10/2010 email exchanges among OCC Joseph Boss, Lee Straus, James Vivencio, Monica Freas, Sally Belshaw, and others, "Bearer Share Accounts" OCC-PSI-00886601.

<sup>1628</sup> 12/11/2007 email from HBUS Jeff Clous to HBUS Paul O'Sullivan and others, "Bearer Share Corporation Policy," OCC-PSI-00226652.

<sup>1629</sup> August 29, 2007 Bearer Share Corporation Account Policy Guidance, OCC-PSI-00226526.

<sup>1630</sup> Id. For more information, see 12/14/2007 HSBC Group Private Banking North America Compliance Report, OCC-PSI-00328384.

policy due to the BVI registration project which had a 2009 deadline.<sup>1631</sup> For the next year, New York IPB and Miami IPB continued to follow their own policies and procedures with regard to bearer share accounts.

**Federal Reserve Concern.** In 2008, an HSBC Group Audit of the New York IPB disclosed that it had 610 bearer share accounts, 31 of which had overdue Beneficial Ownership Letters, including 21 which were overdue by more than a year.<sup>1632</sup> In Miami, an earlier HSBC Group Audit disclosed that, as of October 2007, the Miami IPB had 1,667 bearer share accounts, 1,109 or two-thirds of which had Beneficial Ownership Letters that were more than three years old and so were overdue to get new letters.<sup>1633</sup> Both audits indicated that HBUS was at risk of not knowing, in many cases, who owned the corporations behind the bearer share accounts.

On January 31, 2008, HBUS AML Compliance officer Paul O'Sullivan emailed Clara Hurtado, Compliance officer for the Miami IPB, regarding a "De-Risking Strategy for Miami."<sup>1634</sup> He also discussed with HBUS Compliance head Carolyn Wind and senior AML Compliance officer Alan Williamson the Federal Reserve's concerns regarding the high-risk nature of the Miami IPB's client-base.<sup>1635</sup> Mr. O'Sullivan asked Ms. Hurtado to identify the high risk bearer share accounts for which there was no "glue to cement the relationship" and consider terminating them.<sup>1636</sup>

Six months later, on June 12, 2008, the Federal Reserve issued its annual Report of Examination (ROE) for the Miami IPB. The ROE again identified bearer share accounts as a problem, this time expanding the recommended action to be taken and noting, in particular, that ownership of a bearer share account should be ascertained more frequently than every three years:

<sup>1631</sup> See 4/18/2008 HBUS KYC Committee Meeting minutes, OCC-PSI-00241046. See also 7/3/2008 memorandum from HBUS Ali Kazmy to HBUS Leslie Midzain, OCC-PSI-00292367 ("Since BVI authorities have granted till December 2009 for all bearer shares to be registered, all BVI bearer share corporations within PB Americas will follow this time frame."). Subcommittee briefing by HSBC legal counsel (7/9/2012).

<sup>1632</sup> 10/2008 Group Financial Services Audit October 2008, OCC-PSI-00248215.

<sup>1633</sup> See 10/2007 "HSBC Group Financial Services and European Audit Report on HSBC Private Bank International, Miami and HBUS Domestic Private Banking-Florida Region," OCC-PSI-00223637; see also 12/11/2007 HSBC Private Bank International FSA Audit Issues Status Report, OCC-PSI-00226813.

<sup>1634</sup> 1/31/2008 email from HBUS Paul O'Sullivan to HBUS Alan Williamson and HBUS Carolyn Wind, "De-Risking," OCC-PSI-00331923.

<sup>1635</sup> When asked about the 1,167 bearer share accounts, Ms. Wind told Subcommittee that she knew there were bearer share accounts, but did not know there were that many. She said she had talked about getting rid of bearer share accounts and wanted tighter controls. She also said longstanding bank clients with bearer share accounts were not uncommon in private banking. Subcommittee interview of Carolyn Wind (3/7/2012).

<sup>1636</sup> Id.

“Assess the risks associated with bearer share accounts and establish risk mitigation control measures that are appropriate for the associated level of risk. These control measures may include maintaining control over bearer share accounts; entrusting bearer share accounts with a reliable second party; or requiring periodic certification of ownership. At a minimum, management should conduct a review of the bearer share recertification policy and ensure that accounts that pose higher risks are recertified more frequently than every three years.”<sup>1637</sup>

On June 25, 2008, Peter Georgeou, deputy head of Group Audit Private Bank, emailed the head of HSBC Group audits, Matthew King, addressing the latest Federal Reserve examination report. While the Federal Reserve had listed 13 required actions, Mr. Georgeou alerted Mr. King to those he considered “more material.” On his list was: “Improved controls and risk mitigation are required in respect of bearer share accounts and accounts held in the name of PICs. In addition, policies and procedures should be enhanced for identification and the review of higher risk accounts.”<sup>1638</sup>

On July 3, 2008, HBUS Compliance officer Ali Kazmy sent a memorandum to HBUS Compliance and AML head Lesley Midzain summarizing changes that had been made to the IPB’s AML Procedures for 2007 and 2008. He noted that BVI bearer shares would have to be registered by December 2009, in accordance with the time frame set forth by BVI authorities. He wrote that high risk bearer share accounts would also require annual recertification of beneficial owner information, while lower risk bearer share accounts would need to recertify beneficial ownership every three years. In addition, he wrote that bearer share clients would be required to attest that they will notify the bank if a change in ownership occurs and provide a new Beneficial Ownership Letter.<sup>1639</sup> The next day, July 4, 2008, Jeff Clous, head of IPB Operations in Florida, repeated the concerns he had voiced twice before, to Alan Williamson and Paul O’Sullivan.<sup>1640</sup>

On November 12, 2008, the New York International Private Bank sought dispensation to open 80 new bearer share accounts for existing clients.<sup>1641</sup> New York IPB employee Todd Maddison asked senior

<sup>1637</sup> 6/12/2008 Federal Reserve Audit, at10-11.

<sup>1638</sup> 7/2/2008 email exchanges among HBUS Janet Burak, HBUS Bob Martin, and others, “Federal Reserve Bank of Atlanta Review of HSBC Private Bank Miami,” HBUS OCC-PSI-00725897.

<sup>1639</sup> 7/3/2008 memorandum from HBUS Ali Kazmy to HBUS Lesley Midzain, “Modifications to the Approved Private Bank Americas AML Procedures,” OCC-PSI-00292367.

<sup>1640</sup> 10/29/2008 email exchanges among HBUS Alan Williamson, HBUS Lesley Midzain, and others, “Enquiry – co-branding,” OCC-PSI-00219656.

<sup>1641</sup> 11/14/2008 email exchanges among HBUS Todd Maddison, HBUS Alan Williamson, and others, “Bearer share question,” OCC-PSI-00248782. HBUS legal counsel told the

HBUS Compliance officer Alan Williamson whether Compliance would provide the needed dispensation.<sup>1642</sup> Mr. Maddison said that he thought that an email written by Teresa Garcia, which outlined exceptions to the bearer share policy for the Private Bank, implied that the accounts could be opened under these exceptions:

“Since BVI authorities have granted till December 2009 for all bearer shares to be registered, all BVI bearer share corporations within PB Americas will follow this time frame; High risk bearer share accounts will provide an annual recertification of the beneficial owners through a properly executed BOL; Standard risk bearer share accounts will provide beneficial ownership recertification every three years through a properly executed Beneficial Ownership Letter (BOL); and Clients must attest that they will notify the bank of change in ownership, as and when it takes place. A new BOL will be required from the new beneficial owner.”<sup>1643</sup>

Some of the 80 new bearer share brokerage accounts were opened and some of them, as well as some other New York IPB bearer share accounts, were later moved to the Miami IPB.<sup>1644</sup> On March 18, 2009, the OCC issued a Supervisory Letter addressing AML concerns related to the HBUS Private Banking operations. The letter indicated that one of the OCC’s primary examination objectives was to “[e]valuate effectiveness of enhancements to policies and procedures for PUPID activities, bearer share accounts and monitoring processes.”<sup>1645</sup> Despite this objective, the letter did not address bearer share issues in its conclusions or recommendations.<sup>1646</sup> The OCC’s silence on the issue stands in sharp contrast to the Federal Reserve which was not only aware of the bearer share accounts, but tracking actions taken in Miami with respect to them.

On May 19, 2009, the Federal Reserve issued its annual Report of Examination for the Miami IPB, which again mentioned bearer shares as a concern. It stated in part:

“[T]he risks posed by the international private banking activities remain significant, given the high transactional nature of the client

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Subcommittee that 80 of its clients with bearer shares needed to open brokerage accounts due to a regulatory change. Subcommittee briefing by HBUS legal counsel (7/9/2012).

<sup>1642</sup> 11/14/2008 email exchanges among HBUS Todd Maddison, HBUS Alan Williamson, and others, “Bearer share question,” OCC-PSI-00248782. HBUS legal counsel told the Subcommittee it did not know whether or not a dispensation was granted for these accounts. Subcommittee briefing by HBUS legal counsel (7/9/2012).

<sup>1643</sup> Id.

<sup>1644</sup> Subcommittee briefing by HSBC legal counsel (7/9/2012).

<sup>1645</sup> 3/18/2009 supervisory letter from OCC to HBUS Leslie Midzain, “Private Banking BSA/AML Examination,” OCC-PSI-00000445-447, at 445.

<sup>1646</sup> See 5/10/2010 email from OCC Joseph Boss to OCC Lee Straus, James Vivenzio, Monica Freas, Sally Belshaw, and others, “Bearer Share Accounts,” OCC-PSI-00886601.

base, a higher risk target market (Latin America), and the existence of offshore shell companies (including offshore operating companies), including bearer share structures.”<sup>1647</sup>

The examination report continued that the risk was increasing due to the bank’s transfer of some accounts from the New York International Private Bank to the Miami Edge Corporation. The report also noted that HBUS had taken steps to address the risk. It noted that senior compliance personnel had sought to “de-risk” the Miami IPB’s private banking activities, primarily by:

“continued review of offshore operating shell companies, seeking to exit those relationships where the profitability of the relationships does not justify the additional compliance costs associated with the account. This strategy, coupled with increased approval requirements for new operating company accounts, and a decision to no longer open new bearer share accounts, shows tangible steps taken towards reducing reputational risk at Corporation.”<sup>1648</sup>

This was the third Report of Examination over a two year period to have directed HBUS to strengthen its AML controls over its bearer share accounts.

**2009 Bearer Share Project.** In February 2009, HBUS began the “Bearer Share Project” with the goal of winding down HBUS’ bearer share accounts.<sup>1649</sup> Because the British Virgin Islands (BVI) had passed legislation that would require bearer share certificates to be registered or custodized by the end of the year, HSBC viewed this development as an indication that other laws would soon be passed and decided that it would begin registering or custodizing its bearer shares beginning with the accounts opened by BVI bearer share corporations.<sup>1650</sup> By 2009, HBUS’ international private banks operated under a new organizational structure called Private Bank Americas (PBA), and the bearer shares were treated as a group. PBA determined that it had a total of 1,833 unregistered bearer share accounts, including 1,257 BVI bearer shares and 576 non-BVI bearer shares. It determined that 306 were in the New York Private Bank and 1,527 were in the Miami Private Bank.<sup>1651</sup> The Project began with HBUS’ sending a letter to all of its BVI bearer share

<sup>1647</sup> 5/19/2009 Federal Reserve Report of Examination of Edge Act Corporation, BOG-A-300035. [Sealed Exhibit.]

<sup>1648</sup> Id. at 21.

<sup>1649</sup> Subcommittee briefing by HSBC legal counsel on bearer share issues (4/20/2012 and 7/9/2012).

<sup>1650</sup> Id.

<sup>1651</sup> Id.

clients in May 2009.<sup>1652</sup> The letter explained that as of December 31, 2009, HBUS would “no longer maintain accounts for companies that issue bearer shares.” It indicated that clients would need to register their bearer shares or close their accounts.<sup>1653</sup>

In 2010, the OCC, which had been silent on bearer share issues at HBUS for four years, renewed its focus on the accounts. On May 10, 2010, one of the OCC AML examiners sent an email to EIC Sally Belshaw, OCC attorneys in Washington and others stating that HBUS Compliance head Terry Pesce had told him that all but one bearer share account had been closed in 2006.<sup>1654</sup> One of the OCC attorneys in Washington wrote in an email that he recalled that the examiner “had been told” that there were no bearer share accounts.<sup>1655</sup> The AML examiner indicated that he had just learned that HSBC still had 79 bearer share accounts held in Panama, Uruguay, Bahamas, Cayman, Belize, and Netherlands.<sup>1656</sup> In June 2010, another OCC examiner at HBUS obtained a list from HBUS of 117 bearer share accounts.<sup>1657</sup> On September 8, 2010, the same examiner forwarded a portion of a May 2010 New York IPB report stating it had 610 bearer share accounts, 31 of which had overdue beneficial ownership declarations.<sup>1658</sup> The report also indicated that, for some accounts, the bank had no beneficial ownership declaration on file and no information about the location of some of the shares. Later that same day, the examiner sent another email with a copy of an audit of the Miami IPB indicating it had 925 bearer share accounts, in addition to the 610 accounts in New York.<sup>1659</sup> The examiner agreed to forward the Miami audit report to the Federal Reserve.<sup>1660</sup> These internal communications indicate that a primary reason for OCC inaction on bearer share issues was a misimpression that the accounts had been closed four years earlier.<sup>1661</sup> It also indicates a

<sup>1652</sup> Letter from HBUS to British Virgin Islands bearer share clients, “For Companies Incorporated in the British Virgin Islands,” HSBC-PSI-PROD-0197129-133; Subcommittee briefing by HSBC legal counsel (7/9/2012).

<sup>1653</sup> Letter from HBUS to British Virgin Islands bearer share clients, “For Companies Incorporated in the British Virgin Islands,” HSBC-PSI-PROD-0197129-133, at 129.

<sup>1654</sup> See 5/10/2010 email from OCC Joseph Boss to OCC Lee Straus, James Vivencio, Monica Freas, Sally Belshaw, and others, “Bearer Share Accounts,” OCC-PSI-00886601.

<sup>1655</sup> 9/8/2010 email exchanges among OCC James Vivencio and OCC Teresa Tabor, “Bearer Share Accounts,” OCC-PSI-00894871.

<sup>1656</sup> See 5/10/2010 email from OCC Joseph Boss to OCC Lee Straus, James Vivencio, Monica Freas, Sally Belshaw, and others, “Bearer Share Accounts,” OCC-PSI-00886601.

<sup>1657</sup> 6/15/2010 email from OCC Teresa Tabor to OCC Joseph Boss, [no subject], OCC-PSI-00929779 and attachment OCC-PSI-00929780

<sup>1658</sup> 9/8/2010 email exchanges among OCC James Vivencio and OCC Teresa Tabor, “Bearer Share Accounts,” OCC-PSI-00894871.

<sup>1659</sup> 6/15/2010 email from OCC Teresa Tabor to OCC Joe Boss forwarded to OCC Elsa De La Garza, [no subject], OCC-PSI-00929779 and attachment OCC-PSI-00929780.

<sup>1660</sup> 9/8/2010 email exchanges among OCC Teresa Tabor and OCC Joseph Boss, “IPB Miami (Edge),” OCC-PSI-00921759-760, at 759.

<sup>1661</sup> See also 5/12/2011 conclusion memorandum from OCC Teresa Tabor to OCC Kerry Morse, “Latin American International Center (LAIC) Miami – BSA/AML Examination,” OCC-PSI-01768568 (finding that LAIC had two bearer share accounts which “only came to the attention of the LAIC Compliance Staff based on Examiner inquiries at the commencement of the



lack of coordination with the Federal Reserve which had been monitoring the bearer share issue in Miami for several years.

By the time the OCC became aware of the large number of bearer share accounts still open at HBUS, the Bearer Share Project was well underway in its efforts to reduce the account volume. Having already sent a 2009 letter to accountholders with BVI bearer share corporations about the need to register their shares or close their accounts, HBUS followed in November 2010, by sending a similar letter to all accountholders with non-BVI bearer share corporations.

By June 2011, of the 1257 BVI bearer share accounts, 900 had registered their shares (so that the accounts no longer qualified as bearer share accounts) and 350 accounts had closed.<sup>1662</sup> Of the 576 non-BVI bearer share accounts, 255 had registered their shares, and 182 accounts were closed.<sup>1663</sup> In November 2011, Private Bank Americas froze the remaining 139 non-BVI bearer share accounts, and began working to contact the accountholders and close the accounts.<sup>1664</sup>

As of July 9, 2012, HSBC legal counsel told the Subcommittee that HBUS Private Bank America still had 26 bearer share accounts.<sup>1665</sup> HSBC legal counsel also told the Subcommittee that “all but a handful” of those accounts were frozen, because the accountholders had not registered their shares or closed their accounts.<sup>1666</sup> According to HSBC legal counsel, the handful of bearer share accounts that were not frozen were beneficially owned by a single client, and the shares were being kept in the custody of a law firm in New York. HSBC legal counsel indicated that, although HBUS’ latest bearer share policy continued to allow new bearer share accounts to be opened under limited circumstances, no new bearer share account had, in fact, been opened since that policy took effect.<sup>1667</sup> Internal HBUS documents indicate that as a result of the Bearer Share Project, on at least two occasions, the bank identified suspicious activity related to the accounts.<sup>1668</sup>

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examination”; and that LAIC had not fully followed HBUS bearer share policy for these two accounts because Beneficial Ownership Letters were not obtained every three years and the shares were being held by third-party custodians but it was unclear if the custodians had been approved by LAIC and what approval process was utilized).

<sup>1662</sup> Subcommittee briefing by HSBC legal counsel on bearer share issues (4/20/2012).

<sup>1663</sup> Id.

<sup>1664</sup> Id.

<sup>1665</sup> The Subcommittee was told that 12 accounts are located in Miami and 14 are located in New York. Subcommittee briefing by HSBC legal counsel on bearer share issues (7/9/2012).

<sup>1666</sup> Id.

<sup>1667</sup> Briefing by HSBC legal counsel to the Subcommittee on bearer share issues (4/20/2012).

<sup>1668</sup> See 5/6/2010 AML Oversight Committee Meeting minutes for HBUS, OCC-PSI-00860859-860, at 859.

### C. Two Examples of Bearer Share Accounts

Two examples of bearer share accounts illustrate the AML risks they pose. They involve bearer share accounts opened by Mauricio Cohen Assor and Leon Cohen Levy, which demonstrate how bearer share accounts can be used to conceal assets and evade taxes; and a wealthy Peruvian family, which demonstrates how banks can be pressured to waive AML safeguards when opening bearer share accounts.

**Cohen Bearer Share Accounts.** Mauricio Cohen Assor and Leon Cohen Levy, father and son, were hotel developers in Miami Beach.<sup>1669</sup> On April 14, 2010, both were indicted in Florida on charges of conspiring to commit tax fraud and filing false tax returns.<sup>1670</sup> The Justice Department charged that the Cohens had used bearer share corporations and shell companies to help conceal \$150 million in assets and \$49 million in income from the IRS. Both resided in Miami Beach, Florida.

The indictment explained that “bearer share corporations are often set up in tax havens to hide the true ownership of assets, because ownership records are not maintained and nominee officers and directors are often used to appear to control the affairs of the corporation.”<sup>1671</sup>

The indictment named two bearer share corporations used by the Cohens to open bank accounts, Blue Ocean Finance Ltd., a Panamanian bearer share corporation,<sup>1672</sup> and Whitebury Shipping Time Sharing Ltd., a BVI bearer share company.<sup>1673</sup> The Cohens used those bank accounts to conceal their ownership of the assets deposited into them. The indictment also disclosed that, around May 2007, an unnamed international bank asked one of the Cohens to register the shares of Whitebury Shipping and, when the request was refused, the bank closed the account.

Internal bank documents disclose that HBUS was the unnamed bank that maintained a bearer share account for Whitebury Shipping. April 2007 transcripts of several telephone conversations between Mauricio Cohen and an HBUS banker describe the account, HBUS’ request that he register the bearer shares, and his refusal to do so.

<sup>1669</sup> 10/7/2010 “Miami Beach Hotel Developers Convicted of Tax Fraud,” Department of Justice press release, <http://www.justice.gov/usao/fls/PressReleases/101007-01.html>.

<sup>1670</sup> See generally *United States of America v. Mauricio Cohen Assor and Leon Cohen Levy*, Case No. 10-60159-CR-ZLOCH(s) (USDC SD Flor.), Superseding Indictment (8/3/2010) (hereinafter “Cohen Indictment”). See also “2 Charged in Tax Evasion Scheme Involving HSBC,” *New York Times*, <http://dealbook.nytimes.com/2010/04/16/2-charged-in-tax-evasion-scheme-involving-hsbc/>.

<sup>1671</sup> Cohen Indictment at 3.

<sup>1672</sup> Id. at 7.

<sup>1673</sup> Id. at 8.

According to one of the telephone transcripts, on April 23, 2007, HBUS executive Claude Mandel, the Relationship Manager who handled the bank's relationship with Mauricio Cohen, apparently agreed to remove Mr. Cohen's name from the Whitebury account.<sup>1674</sup> The next day, Mr. Cohen talked to Mr. Mandel about replacing Whitebury with another bearer share account. Mr. Mandel offered to convert Whitebury from a BVI to a Bahamian bearer share corporation, but said that the bank no longer opened bearer share accounts. Mr. Cohen protested and told Mr. Mandel that the bank would lose clients and that other banks take bearer share accounts.<sup>1675</sup> The telephone transcripts indicate that, on April 25, 2007, Mr. Mandel and Mr. Cohen again discussed Mr. Cohen's bearer share accounts. Despite Mr. Mandel's insisting that his bearer shares would need to be registered, Mr. Cohen convinced Mr. Mandel to check if he could convert Whitebury into a Panamanian bearer share corporation. Mr. Cohen indicated again that he did not want to put names on the shares; when Mr. Mandel said that the shares would need to state the names, Mr. Cohen said: "But, I can't put that, otherwise I have to declare them in the United States? I can't do that, I don't want to declare ... otherwise, I have to close the accounts with you and go to Geneva."<sup>1676</sup>

Minutes from a May 6, 2010 AML Oversight Committee Meeting at HBUS noted that the HBUS Private Bank was providing information on closed bearer share accounts opened by an "ex-client" as part of the investigation of Mauricio Cohen, a former HSBC client.<sup>1677</sup>

In October 2010, the Cohens were convicted after a jury trial, sentenced to ten years in prison, and ordered to pay back taxes, interest, and penalties totaling over \$17 million. This example demonstrates the risk of bearer share accounts being used to conceal ownership of assets and commit criminal tax evasion.

**Peruvian Family Bearer Share Accounts.** In 2007, a senior Compliance official with the HSBC Private Bank in New York, Teresa Garcia, sought a waiver to open a relationship for a Peruvian businessman for two bearer share accounts.<sup>1678</sup> According to Ms. Garcia, his business group was one of the richest and most powerful in Peru.<sup>1679</sup>

<sup>1674</sup> Transcript of 4/23/2007 telephone conversation between HBUS Claude Mandel and Mauricio Cohen, HSBC-PSI-PROD-0030891-894.

<sup>1675</sup> Transcript of 4/24/2007 telephone conversation between HBUS Claude Mandel and Mauricio Cohen, HSBC-PSI-PROD-0030873-877.

<sup>1676</sup> Transcript of 4/25/2007 telephone conversation between HBUS Claude Mandel and Mauricio Cohen, HSBC-PSI-PROD-0024791-793.

<sup>1677</sup> 5/6/2010 HBUS AML Oversight Committee Meeting Minutes, OCC-PSI-00860859, at 859.

<sup>1678</sup> 6/20/2007 email exchange among HBUS Teresa Garcia and HBUS Alan Williamson, "Waiver Request," OCC-PSI-00214516, at 3.

<sup>1679</sup> Id. at 3.

The bearer share corporations, Urigeler International S.A. - Holding Company and Birmingham Merchant S.A. - Holding Company, were formed in Panama.<sup>1680</sup> According to an email exchange among HBUS Compliance personnel, in 2007, opening a new bearer share account required: (1) approval by the New York International Private Bank CEO and AML Local Compliance Officer; and (2) registration or custodization of the bearer shares.<sup>1681</sup>

Ms. Garcia wrote that she was requesting the waiver because the businessman had indicated that he did not want to forfeit confidentiality by registering or custodizing the bearer shares.<sup>1682</sup> She explained: "they wish to maintain confidentiality, and they have never been asked by our competitors with whom they bank to do this."<sup>1683</sup> Manuel Diaz, President and Managing Director of HSBC Private Bank International in Miami, indicated that he supported a waiver, because he was very familiar with the family and interested in establishing a relationship with them.<sup>1684</sup> Marlon Young, CEO of Private Banking Americas, also approved the waiver request.<sup>1685</sup>

Ms. Garcia then escalated the request to senior HBUS Compliance official Alan Williamson to determine who had authority to grant the waiver on behalf of AML Compliance. Mr. Williamson explained that, while he had no objection to granting the waiver, the bearer shares policy was an HSBC Group mandate and any exception would have to be approved by HSBC Group Compliance.<sup>1686</sup> David Ford, HSBC Global Money Laundering Control Officer, confirmed that HSBC Group approval was required for an exception to Group policy. Mr. Ford also wrote that he was "[s]uprised can open bearer share account for offshore client with no bo [beneficial ownership] declaration in US," and suggested checking with HBUS Compliance head Carolyn Wind about the OCC and Federal Reserve "view of such a structure."<sup>1687</sup> Mr. Williamson asked HSBC Group AML head Susan Wright about the

<sup>1680</sup> 6/20/2007 email exchange among HBUS Teresa Garcia and HBUS Alan Williamson, "Waiver Request," OCC-PSI-00214516, at 2.

<sup>1681</sup> Id. at 1.

<sup>1682</sup> 7/5/2007 email exchange among HBUS Teresa Garcia and HBUS Alan Williamson, Susan Hoggarth, and others, "[redacted] Family," OCC-PSI-00215211, at 6.

<sup>1683</sup> 6/21/2007 email exchange among HBUS Alan Williamson and HBUS Marlon Young, Manuel Diaz, Teresa Garcia, and others, "Waiver Request," OCC-PSI-00214618, at 3-4.

<sup>1684</sup> 6/20/2007 email exchange among HBUS Teresa Garcia and HBUS Alan Williamson, "Waiver Request," OCC-PSI-00214516, at 3.

<sup>1685</sup> 6/25/2007 email from HBUS Marlon Young to HBUS Jaime Carvallo and others, "[redacted] Family," OCC-PSI-00214806.

<sup>1686</sup> 6/21/2007 email exchange among HBUS Alan Williamson and HBUS Marlon Young, Manuel Diaz, Teresa Garcia, and others, "Waiver Request," OCC-PSI-00214618, at 3.

<sup>1687</sup> Id. at 1.

request, and reported that she was reluctant to grant the exception but would consider it.<sup>1688</sup>

There was a strong push for this relationship by the business side. Manuel Diaz, head of the Miami Private Bank International, wrote: "I FULLY SUPPORT THIS WAIVER."<sup>1689</sup> Jaime Carvallo, a Miami bank executive, sent an email to the head of Private Banking Americas, Marlon Young, enlisting his support to obtain a waiver. Mr. Carvallo wrote:

"Teresa Garcia must have given you heads up on the [redacted] family and the issue regarding their holding companies having bearer shares and the fact that they will not sign the BOL [Beneficial Ownership Letter].

I will see one of the family members tomorrow morning and this still seems to have no resolution. This is too important a family in Peru for us not to want to do business with, and one that has taken a lot of my time and effort to convince to start a relationship with us. ... I would appreciate your involvement at this point, as this has become extremely sensitive."<sup>1690</sup>

Mr. Young signaled his support for the waiver the same day,<sup>1691</sup> and later wrote to senior HBUS Compliance officer Alan Williamson: "This is an important relationship for IPB [International Private Bank] and a family that has a clean record. It would be a shame if we are not able to obtain an exception."<sup>1692</sup> Mr. Cavallo also wrote directly to Mr. Williamson that the family was "too important a family in Peru for us not to want to do business with."<sup>1693</sup> Mr. Carvallo estimated the family's liquid net worth,<sup>1694</sup> and explained that HSBC was currently competing with another bank to help the family reorganize their businesses and facilitate the succession of their financial assets and operating companies, which could be very profitable.<sup>1695</sup>

<sup>1688</sup> 6/26/2007 email exchange among HBUS Alan Williamson and HBUS Jaime Carvallo, Marlon Young, Manuel Diaz, Teresa Garcia, and others, "[redacted] Family," OCC-PSI-00214880, at 1.

<sup>1689</sup> 6/20/2007 email exchange among HBUS Alan Williamson and HBUS Manuel Diaz, Teresa Garcia, and others, "Waiver Request," OCC-PSI-00214534, at 1.

<sup>1690</sup> 6/25/2007 email from HBUS Jaime Carvallo to HBUS Marlon Young and others, "[redacted] Family," OCC-PSI-00214806.

<sup>1691</sup> 6/25/2007 email from HBUS Marlon Young to HBUS Jaime Carvallo and others, "[redacted] Family," OCC-PSI-00214806.

<sup>1692</sup> 6/26/2007 email from HBUS Marlon Young to HBUS Alan Williamson and others, "[redacted] Family," OCC-PSI-00214891, at 1-2.

<sup>1693</sup> 7/5/2007 email exchange among HBUS Teresa Garcia and HBUS Alan Williamson, Susan Hoggarth, and others, "[redacted] Family," OCC-PSI-00215211, at 6.

<sup>1694</sup> 6/26/2007 email exchange among HBUS Alan Williamson and HBUS Jaime Carvallo, Marlon Young, Manuel Diaz, Teresa Garcia, and others, "[redacted] Family," OCC-PSI-00214880, at 1.

<sup>1695</sup> 7/5/2007 email exchange among HBUS Teresa Garcia and HBUS Alan Williamson, Susan Hoggarth, and others, "[redacted] Family," OCC-PSI-00215211, at 5.

Mr. Williamson responded: “I thought so. I would do it without going to Geneva but audit wrote up DPB [Domestic Private Banking] on a similar situation.”<sup>1696</sup> Later, he wrote: “we will do our best.”<sup>1697</sup> Still later: “Doing what I can.”<sup>1698</sup> David Ford pointed out that the HSBC Group policy was flexible, because the client could either declare beneficial ownership, have HSBC hold the shares, or have an acceptable third party hold the shares.<sup>1699</sup> On July 5, 2007, Mr. Williamson wrote that the “RM [Relationship Manager] and the Group Head are not seeing eye to eye on this one.”<sup>1700</sup>

In 2007, HBUS opened a bearer share account in the name of Urigeler.<sup>1701</sup> When asked whether a waiver had been granted from the requirements that the bank hold the shares in custody and obtain an Beneficial Ownership Letter from the owner, HSBC legal counsel told the Subcommittee: “We don’t know.”<sup>1702</sup> HSBC legal counsel told the Subcommittee that the accounts was opened in New York, transferred to Miami in 2009, and closed in 2011.<sup>1703</sup>

This account demonstrates the difficulty of adhering to a strong bearer share policy when a wealthy and powerful family asks to open a bearer share account and obtain a waiver from requirements to either register the shares with their names or submit the shares to the custody of the bank. HBUS’ bearer share policy continues to permit the bank to open bearer share accounts.

#### D. Analysis

For decades, bank regulators and AML experts have cautioned against opening accounts for bearer share corporations due to the ease with which these corporations hide ownership and the frequency with which they have been used to commit money laundering, financial crime, tax evasion, and other wrongdoing. From at least 2000 to 2011, HBUS maintained a sizeable number of bearer share accounts, despite

<sup>1696</sup> 6/20/2007 email exchange among HBUS Alan Williamson and HBUS Manuel Diaz, Teresa Garcia, and others, “Waiver Request,” OCC-PSI-00214534, at 1.

<sup>1697</sup> 6/21/2007 email exchange among HBUS Alan Williamson and HBUS Marlon Young, Manuel Diaz, Teresa Garcia, and others, “Waiver Request,” OCC-PSI-00214618, at 1.

<sup>1698</sup> 6/26/2007 email from HBUS Alan Williamson to HBUS Marlon Young and others, “[redacted] Family,” OCC-PSI-00214891, at 1. See also 7/5/2007 email exchange among HBUS Teresa Garcia and HBUS Alan Williamson, Susan Hoggarth, and others, “[redacted] Family,” OCC-PSI-00215211; 6/26/2007 email exchange among HBUS Alan Williamson and HBUS Marlon Young, Manuel Diaz, Teresa Garcia, and others, “[redacted] Family,” OCC-PSI-00214891.

<sup>1699</sup> 7/5/2007 email exchange among HBUS Teresa Garcia and HBUS Alan Williamson, Susan Hoggarth, and others, “[redacted] Family,” OCC-PSI-00215211, at 2.

<sup>1700</sup> Id. at 1.

<sup>1701</sup> Subcommittee briefing by HSBC legal counsel (7/9/2012).

<sup>1702</sup> Id.

<sup>1703</sup> Id.

repeated regulatory questions and expressions of concern. HBUS bankers, and at times their compliance officers, pushed to open and maintain bearer share accounts. Two bearer share accounts illustrate the risks inherent in such accounts and the pressures to circumvent AML controls. While HBUS finally registered or closed most of the accounts by 2011, its policy continues to allow bearer share accounts to be opened under some circumstances.

## VIII. OCC: EXERCISING INEFFECTIVE AML OVERSIGHT

The mission of the Office of the Comptroller of the Currency (OCC) is to charter, regulate, and supervise all U.S. banks that hold a national charter.<sup>1704</sup> To carry out that mission, in the words of the OCC, it conducts “regular examinations to ensure that institutions under our supervision operate safely and soundly and in compliance with laws and regulations,” including AML laws.<sup>1705</sup> However, the HSBC case history, like the Riggs Bank case history examined by this Subcommittee eight years ago,<sup>1706</sup> provides evidence that the current OCC examination system has tolerated severe AML deficiencies for years and given banks great leeway to address targeted AML problems without ensuring the effectiveness of their AML program as a whole. As a result, the current OCC examination process has allowed AML issues to accumulate into a massive problem before an OCC enforcement action is taken.

At HSBC, during the five-year period from 2005 to 2010, OCC AML examiners conducted nearly four dozen AML examinations, identified at least 83 AML Matters Requiring Attention, and recommended two cease and desist orders to strengthen HBUS’ AML program. Despite the many AML problems identified by its examiners, OCC supervisors took no formal or informal enforcement action during nearly that entire period, allowing the bank’s AML problems to fester. In 2009, after learning that two law enforcement agencies were investigating possible money laundering through HBUS accounts, the OCC legal and enforcement divisions directed OCC AML examiners to hastily intensify and expand an ongoing AML examination to consider HBUS’ AML program as a whole. In September 2010, the expanded OCC examination culminated in a blistering Supervisory Letter identifying numerous, serious AML problems at the bank. Many of these AML problems had been identified in prior examinations, but were tied to specific HBUS business units rather than applied bankwide, and were not resolved by bank commitments to remedy the identified problems.

The September 13, 2010 Supervisory Letter criticizing HBUS’ AML deficiencies ran 31 pages long.<sup>1707</sup> It cited the bank for five violations of Federal AML law. Its list of AML problems included a backlog of over 17,000 unreviewed alerts regarding possible suspicious

<sup>1704</sup> See “FAQs – HSBC Money Laundering Enforcement Action,” attached to 10/6/2010 email from OCC James Vivenzio to OCC colleagues, “HSBC FAQs,” OCC-PSI-00898845, at 5.

<sup>1705</sup> *Id.*

<sup>1706</sup> See “Money Laundering and Foreign Corruption: Enforcement and Effectiveness of the Patriot Act,” U.S. Senate Permanent Subcommittee on Investigations, S.Hrg. 108-633 (July 15, 2004).

<sup>1707</sup> 9/13/2010 OCC Supervisory Letter HSBC-2010-22, “Bank Secrecy Act/Anti-Money Laundering (‘BSA/AML’) Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21),” OCC-PSI-00864335, at 342. [Sealed Exhibit.]



activity, and a failure to timely file hundreds of Suspicious Activity Reports (SARs) based upon those alerts. The Supervisory Letter also criticized HBUS for failing to conduct any due diligence or to assess the AML risks posed by HSBC affiliates that opened U.S. dollar correspondent accounts at HBUS, even though many of those affiliates operated in high risk jurisdictions, had high risk clients, or offered high risk products. Another problem was a three-year failure by HBUS, from mid-2006 to mid-2009, to conduct any AML monitoring of billions of dollars in bulk cash transactions, including \$15 billion from 2007 to 2008 alone, with those same HSBC affiliates, despite the risks associated with large cash transactions.

In addition, the Supervisory Letter criticized HBUS' failure to conduct any AML monitoring of \$60 trillion annually in wire transfer activity by customers domiciled in countries rated by HBUS as lower risk, unless a customer was individually rated as high risk, while also criticizing the bank's country risk assessment process. The OCC attributed the bank's monitoring failure in part to HBUS' goal of minimizing AML staffing requirements. To place the magnitude of the AML vulnerability created by HBUS in context, the OCC noted that, from 2005 to 2009, HBUS' wire activity had grown from 20.4 million to 30.2 million wire transactions per year, with annual dollar volumes climbing from \$62.4 trillion to \$94.5 trillion, an increase of 50%. The OCC also noted that HBUS had become the third largest user of the CHIPS wire transfer system which provides 95% of U.S. dollar cross-border and nearly half of all domestic wire transactions totaling \$1.5 trillion daily.<sup>1708</sup>

The letter didn't stop there. It also offered a slew of criticisms of the techniques used by HBUS to identify suspicious activity, describing them as "ineffective," "inadequate," and overly reliant on a "highly discretionary manual monitoring approach," all of which decreased the number of AML alerts. Additional problems included inappropriate procedures to close alerts; an "inadequate focus on country risk instead of customer risk"; the failure to assign high risk ratings to high risk clients, including Politically Exposed Persons; inadequate and unqualified AML staffing; inadequate AML resources; and high turnover in AML leadership. Despite its own failures to take proactive steps to oversee the bank, the OCC letter noted that the bank had not been proactive enough in identifying and remediating its own AML problems:

"Through year-end 2009, the OCC has issued 83 BSA/AML Matters Requiring Attention ('MRAs'). The bank has a history of not identifying BSA/AML problems proactively. Instead, the bank has taken a reactive posture, choosing to focus its attention on correcting specific deficiencies identified by regulators without

<sup>1708</sup> Id. at 342-343.

taking comprehensive action to identify and correct deficiencies in the bank's overall BSA/AML program."<sup>1709</sup>

A month later, on October 4, 2010, the OCC issued a Cease and Desist Order requiring HBUS to revamp its AML program.<sup>1710</sup> In response, HBUS committed to making major changes.

At the time the OCC issued the October Cease and Desist Order, it had been conducting regular AML oversight of HBUS for six years, raising the issue of how such deep-seated AML deficiencies could have gone on at the bank without the regulator's taking action. Part of the answer is that HBUS, like other international banks, presented the OCC with a number of AML challenges. It functioned as the U.S. nexus for one of the largest banks in the world. The HSBC network was not based in the United States, and its central focus was not on U.S. customers or U.S. businesses, but on other areas of the globe. HSBC affiliates operated in a number of jurisdictions which faced huge AML risks from terrorist financing, drug trafficking, tax evasion, and other law enforcement problems. The HSBC Group was also one of the largest participants in international wire transfer systems and a leader among global banks in moving large amounts of physical currency around the world, with all the attendant AML risks inherent in large cash transactions. HSBC also handled numerous high risk clients and high risk products. In addition, as OCC examinations disclosed over the years, it was a financial institution with inadequate AML resources; inadequate AML systems and controls; and inadequate AML leadership.

HBUS itself was a large, complex, and growing financial institution with numerous business lines, products, and services, as well as millions of customers. It also had correspondent accounts for more than 80 HSBC affiliates as well as financial institutions around the world. From the time the OCC became HBUS' primary regulator in 2004, it oversaw HBUS' AML program and conducted regular examinations throughout the bank. Year after year, those AML examinations exposed AML deficiencies. Each time problems were identified, HBUS promised to correct them and sometimes did. But those corrective actions were narrowly targeted and, instead of improving, the bank's overall AML program deteriorated, resulting in the dramatic failures described in the September 2010 Supervisory Letter.

<sup>1709</sup> Id.

<sup>1710</sup> See In re HSBC Bank USA, N.A., Case No. AA-EC-10-98, Department of the Treasury Comptroller of the Currency, Consent Order (10/4/2012), OCC-PSI-00904698. On the same day, the Federal Reserve issued a Cease and Desist Order against HBUS' holding company, HSBC North America Holdings, Inc. (HNAH) to require it to strengthen its AML program. See In Re HSBC North America Holdings, Inc., Case No. 10-202-B-HC, before the Board of Governors of the Federal Reserve System, Cease and Desist Order Issued Upon Consent Pursuant to the Federal Deposit Insurance Act as Amended (10/4/2012).

The focus of this section is to chronicle the OCC's AML oversight efforts at HBUS and draw from that case history potential lessons regarding OCC examinations of AML controls at a large global bank; how AML problems can accumulate over years despite the OCC's presence; and what can be done to strengthen the OCC's AML oversight. Problems include the OCC's decision to treat AML deficiencies as a consumer compliance problem rather than a management problem with safety and soundness implications; its practice of foregoing the citation of legal violations for the failure to comply with mandated components of a AML program; its use of narrowly focused AML examinations without also examining a bank's overall AML program; its failure to make timely use of informal and formal enforcement actions to compel AML improvements; and its use of Supervisory Letters that sometimes muted examination criticisms or weakened recommendations for reforms. Actions to remedy these problems would strengthen the OCC's AML oversight and help protect the U.S. banking system from being misused for terrorist financing, money laundering or other misconduct.

## **A. Background**

### **(1) Key Anti-Money Laundering Laws**

Federal law defines money laundering as "the movement of illicit cash or cash equivalent proceeds into, out of, or through the United States [or] ... United States financial institutions."<sup>1711</sup> Federal anti-money laundering laws also apply to terrorist financing, including any legally obtained funds if intended for use in planning, committing, or concealing a terrorist act.<sup>1712</sup> These laws arose as a result of law enforcement investigations demonstrating that terrorists, drug traffickers, tax evaders, and other criminals were using financial transactions to execute their crimes, including by transferring funds across international lines, recharacterizing illicit proceeds as legitimate funds, hiding assets, and using financial and corporate secrecy laws and practices to block inquiries into their activities. U.S. AML laws are designed to prevent these wrongdoers from misusing the U.S. financial system to commit their crimes.

Three key laws lay out the basic AML obligations of U.S. financial institutions, the Money Laundering Control Act of 1986, the Bank Secrecy Act of 1970, and the USA Patriot Act of 2002, which amended both prior laws.<sup>1713</sup>

<sup>1711</sup> 31 U.S.C. § 5340(2).

<sup>1712</sup> See, e.g., 18 U.S.C. § 981(a)(1)(G) (civil forfeiture laws applicable to laundered proceeds also apply to terrorist assets).

<sup>1713</sup> For a more detailed discussion of U.S. AML laws, see "Anti-Money Laundering: Issues Concerning Depository Institution Regulator Oversight," testimony of the General Accounting

The Money Laundering Control Act, enacted partly in response to hearings held by this Subcommittee in 1985, was the first law in the world to make money laundering a crime. It prohibits any person from knowingly engaging in a financial transaction which involves the proceeds of a “specified unlawful activity.”<sup>1714</sup> The law provides a long list of specified unlawful activities, including, for example, terrorism, drug trafficking, fraud, and foreign corruption. The Bank Secrecy Act (BSA), as amended by the Patriot Act, imposes AML obligations on a designated list of financial institutions operating in the United States to ensure they do not facilitate money laundering or become conduits for terrorist financing.

**AML Requirements.** The Bank Secrecy Act mandates that covered financial institutions establish an effective AML program that meets four minimum requirements:

- 1) It has a system of internal controls to ensure ongoing compliance.
- 2) It designates an individual responsible for managing AML compliance.
- 3) It provides AML training for appropriate personnel.
- 4) It requires independent testing of AML compliance.<sup>1715</sup>

These four components are sometimes referred to as the “pillars” of an effective AML program. The first requirement for a system of AML “internal controls” involves development of risk-based policies and procedures to detect and prevent money laundering.<sup>1716</sup> At a large bank, these safeguards would include Know Your Customer (KYC) policies and procedures, including developing a customer identification program, conducting due diligence reviews, and assessing customer risk; a monitoring system to analyze account and wire transfer activity to detect suspicious activity; and a system for reporting suspicious activity to law enforcement. To ensure AML controls are implemented effectively, banks are also required to provide appropriate resources, infrastructure, and staff.

The second requirement is to designate a qualified individual for coordinating and monitoring the bank’s day-to-day AML compliance.<sup>1717</sup> The AML compliance officer must be knowledgeable about the law and have the time, expertise, authority, and resources needed to ensure bank compliance with AML requirements. The AML compliance officer should also have the authority to make regular reports to the bank’s board of directors or a board designated committee.

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Office, Report No. GAO-04-833T, (6/3/2004), before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, at 4-6. <http://www.gao.gov/new.items/d04833t.pdf>

<sup>1714</sup> 18 U.S.C. §§ 1956-57.

<sup>1715</sup> See 31 U.S.C. § 5318(h)(1) and 12 C.F.R. Section 21.21(b)(1). All Federal bank regulators have adopted the same requirements within their own regulations.

<sup>1716</sup> 31 U.S.C. § 5318(h)(1)(A) and 12 C.F.R. Section 21.21(c)(1).

<sup>1717</sup> 31 U.S.C. § 5318(h)(1)(B) and 12 C.F.R. Section 21.21(c)(3).

The third requirement is for the bank to provide adequate training to all personnel with AML responsibilities.<sup>1718</sup> AML training should be ongoing to ensure bank personnel are kept up-to-date with the law. The fourth requirement is for the bank to conduct independent testing of its AML program and controls to ensure compliance with the law and to identify and correct any AML deficiencies.<sup>1719</sup> This function is typically performed by a bank's internal audit group or by an outside auditor with AML expertise.

**Other AML Requirements.** In addition to requiring covered financial institutions to establish effective AML programs, Federal AML laws include a number of other statutory requirements, including requiring banks that keep records outside of the United States to produce them within a specified period of time,<sup>1720</sup> to obtain identifying information for persons seeking to open or maintain accounts,<sup>1721</sup> and requiring appropriate due diligence when opening and administering accounts for foreign financial institutions or senior foreign political figures.<sup>1722</sup> The Bank Secrecy Act also authorizes and the U.S. Department of Treasury has issued regulations requiring covered financial institutions and other businesses to file reports on large currency transactions and suspicious activities to guard against money laundering.<sup>1723</sup>

## (2) AML Oversight In General

The Secretary of the Treasury is the primary Federal regulator charged with enforcing key Federal AML laws.<sup>1724</sup> To help carry out those responsibilities, in 2003, the Secretary established the Executive Office for Terrorist Financing and Financial Crimes, headed by a Deputy Assistant Secretary. This office oversees the operation of the Financial Crimes Enforcement Network (FinCEN), a Treasury bureau which, among other duties, develops AML regulations and guidance, analyzes currency transaction reports and suspicious activity reports filed by financial institutions, and interacts with local, state, Federal, and international law enforcement as well as other financial intelligence units around the world. Treasury also oversees the Office of Foreign Assets Control (OFAC) which is primarily responsible for enforcing U.S. sanctions laws to detect and block financial transactions and assets

<sup>1718</sup> 31 U.S.C. § 5318(h)(1)(C) and 12 C.F.R. Section 21.21(c)(4).

<sup>1719</sup> 31 U.S.C. § 5318(h)(1)(C) and 12 C.F.R. Section 21.21(c)(2).

<sup>1720</sup> 31 U.S.C. § 5318(k)(2).

<sup>1721</sup> 31 U.S.C. § 5318(l).

<sup>1722</sup> 31 U.S.C. § 5318(i).

<sup>1723</sup> See, e.g., 31 U.S.C. §§ 5313 and 5318(g); 31 C.F.R. §§ 103.11 and 103.21 et seq.

<sup>1724</sup> See, e.g. 31 U.S.C. §§ 5311 et seq. (Treasury Secretary charged with carrying out key anti-money laundering laws) and § 5341 (Treasury Secretary given lead role in development of national anti-money laundering strategy).

belonging to identified terrorists, persons associated with weapons of mass destruction, drug traffickers, and rogue jurisdictions.

Although FinCEN is the administrator of Federal AML regulations in the United States, it does not examine banks. That task is assigned to Federal bank regulators which are charged with monitoring bank compliance with AML laws through their examination procedures. Any AML violations they discover are reported to FinCEN which can, among other actions, impose civil monetary penalties on financial institutions for the violations.<sup>1725</sup>

Significant responsibility for AML oversight, thus, rests with Federal bank regulators. The decisions they make with respect to AML policies and procedures, AML examinations, and safety and soundness ratings consequences for AML deficiencies will in large measure determine the importance that both regulators and financial institutions place on achieving effective AML controls.

**Oversight of Financial Institutions.** At the end of 2010, the United States had over 7,600 federally insured commercial banks and savings institutions.<sup>1726</sup> In addition, the United States had over 7,300 federally insured credit unions.<sup>1727</sup> On the federal level, these financial institutions are overseen by four agencies: the Federal Reserve which supervises state-chartered banks that are part of the Federal Reserve System and certain financial holding companies; the Federal Deposit Insurance Corporation (FDIC) which supervises state-chartered banks that were not part of the Federal Reserve System;<sup>1728</sup> the Office of the Comptroller of the Currency (OCC) which supervises banks and savings associations with national charters, and certain U.S. affiliates of foreign-owned banks;<sup>1729</sup> and the National Credit Union Administration (NCUA) which supervises Federal and state-chartered credit unions. In addition, state banking authorities supervise and examine state-chartered institutions.

<sup>1725</sup> See FinCEN Enforcement Actions, [http://www.fincen.gov/news\\_room/ea/](http://www.fincen.gov/news_room/ea/) ("Under the Bank Secrecy Act (BSA), 31 U.S.C. 5311 et seq., and its implementing regulations at 31 C.F.R. Chapter X (formerly 31 C.F.R. Part 103), FinCEN may bring an enforcement action for violations of the reporting, recordkeeping, or other requirements of the BSA. FinCEN's Office of Enforcement evaluates enforcement matters that may result in a variety of remedies, including the assessment of civil money penalties.").

<sup>1726</sup> See the Federal Deposit Insurance Corporation's (FDIC) Statistics at a Glance, (Fourth Quarter 2010). This includes 6,529 commercial banks and 1,128 savings institutions. <http://www.fdic.gov/bank/statistical/stats/2010dec/industry.html>

<sup>1727</sup> See the National Credit Union Administration's (NCUA) 2010 Annual Report, "Insurance Fund Ten-Year Trends" chart, page 133. This figure includes 4,589 Federal and 2,750 state-chartered credit unions. <http://www.ncua.gov/Legal/Documents/Reports/AR2010.pdf>

<sup>1728</sup> The FDIC also acts as a backup regulator for all financial institutions with Federal deposit insurance.

<sup>1729</sup> Until recently, the Office of Thrift Supervision (OTS) supervised Federal savings associations and institutions, but it was abolished by the Dodd Frank Wall Street Reform and Consumer Protection Act. All OTS duties were officially transferred to the OCC on July 21, 2011.

The primary responsibility of the Federal bank regulators is to ensure the “safety and soundness” of the financial institutions they supervise. One key mechanism they use to carry out that responsibility is to conduct safety and soundness examinations on a periodic basis and provide the results in an annual Report of Examination (ROE) to the Board of Directors of each financial institution. Safety and soundness examinations are conducted to assess the risk that an insured bank poses to the Federal Deposit Insurance Fund. All FDIC-insured institutions contribute to this insurance fund through assessments which are typically collected on a quarterly basis. The assessment amounts are based, in part, on a bank’s safety and soundness ratings.

The largest U.S. financial institutions are supervised under a “continuous examination” program. Under this program, examiners are always on-site at the institution, as opposed to periodically arriving on-site, conducting an examination, and then departing for the next bank after finalizing the ROE. Examinations at smaller community banks are typically conducted on a 12- or 18-month exam cycle. Examiners are typically on-site at smaller community banks for only a few weeks.

**Interagency AML Examination Manual.** In June 2005, the Federal Financial Institutions Examination Council (FFIEC) issued a joint AML Examination Manual.<sup>1730</sup> This manual was developed by the Federal bank regulators, in collaboration with FinCEN, OFAC, and state banking agencies. It was developed to provide current and consistent AML examination procedures and guidance to examiners across the Federal banking agencies and the financial institutions they oversee. The manual has been updated three times to incorporate regulatory changes and reflect feedback from the banking industry and examination staff. The most recent version of the manual was released in April 2010.<sup>1731</sup>

**Safety and Soundness Examinations.** Federal bank regulators conduct several different examinations at the financial institutions they supervise. The most important is the safety and soundness examination. Federal bank regulators conduct safety and soundness examinations to assess the risks that a bank poses to the Federal Deposit Insurance Fund (DIF) and to maintain public confidence in the integrity of the banking

<sup>1730</sup> The FFIEC is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the Federal examination of financial institutions by the Federal Reserve, FDIC, OCC, NCUA, and the Consumer Financial Protection Bureau (CFPB), and to make recommendations to promote uniformity in the supervision of financial institutions. See FFIEC website, <http://www.ffiec.gov/>. In 2006, the State Liaison Committee (SLC) was added to the Council as a voting member. The SLC includes representatives from the Conference of State Bank Supervisors, the American Council of State Savings Supervisors, and the National Association of State Credit Union Supervisors. The CFPB became an FFIEC member in 2011. The Office of Thrift Supervision was also an FFIEC member, until the agency was abolished in 2011.

<sup>1731</sup> See 4/29/2010 “BSA/AML Examination Manual,” Federal Financial Institutions Examination Council, [http://www.ffiec.gov/bsa\\_aml\\_infobase/documents/BSA\\_AML\\_Man\\_2010.pdf](http://www.ffiec.gov/bsa_aml_infobase/documents/BSA_AML_Man_2010.pdf).

system. These examinations help prevent identified problems from deteriorating to the point of bank failures, the costs of which are often borne by the DIF. The DIF is funded by assessments that the FDIC charges banks. These assessments are derived from the level of insured deposits that a bank holds and the inherent risks that the bank poses to the DIF, which are calculated in part from a bank's safety and soundness component ratings and composite rating.

Safety and soundness examinations are designed to determine the financial condition of an institution, assess the effectiveness of its risk management practices, and aid in the development of effective and timely corrective actions. The examinations evaluate the bank's adherence to a variety of laws and regulations, identify and assess key risks, and identify and assess any problems.

**CAMELS Ratings.** Safety and soundness examinations are organized around a rating system called CAMELS, an acronym for the six components that are evaluated. The CAMELS rating system evaluates a financial institution's: (C) capital adequacy, (A) asset quality, (M) management effectiveness, (E) earnings, (L) liquidity, and (S) sensitivity to market risk. Each component of the CAMELS rating is based upon a qualitative analysis of various factors comprising it. CAMELS ratings use a scale of 1 to 5, with "1" being the best rating and "5" the worst.

The CAMELS component ratings also serves as the basis for a bank's "Composite Uniform Financial Institution Rating," often referred to as the "composite rating" or the overall "bank rating." The composite rating also uses a scale of 1 to 5, and generally bears a close relationship to the component CAMELS ratings, although it is not simply an average of them. For composite ratings, 1 is the highest rating and signifies a safe and sound institution with no cause for supervisory concern, 3 signifies an institution with supervisory concerns in one or more areas, and 5 is the lowest rating, which signifies an unsafe and unsound bank with severe supervisory concerns.

When the FDIC assesses bank insurance fees for a particular institution, it takes into consideration both the CAMELS component ratings and the composite rating. Lower ratings, signifying a higher risk institution and a greater threat to the Deposit Insurance Fund, can lead to a higher deposit insurance assessment,<sup>1732</sup> which in turn can affect net income.

**Specialty Examinations and Ratings.** In addition to safety and soundness examinations, Federal bank regulators also conduct various specialty or secondary examinations targeting particular aspects of the

<sup>1732</sup> See page 3 – sample deposit insurance assessment invoice, <http://www.fdic.gov/deposit/insurance/assessments/EV2Sample.pdf>.



institutions they supervise. These specialty examinations, which are separate and distinct from safety and soundness examinations, are important in their own right, and focus on such areas as information technology (IT), trust operations, compliance with the Community Reinvestment Act (CRA), and compliance with consumer protection laws.<sup>1733</sup>

Each of these specialty examinations has its own unique rating system based upon an interagency agreement on what elements should be considered and how the rating should be calculated. For example, IT examinations produce ratings under a "Uniform Rating System for Information Technology"; trust examinations produce ratings under a "Composite Uniform Interagency Trust Rating" system; CRA examinations produce ratings under a "Community Reinvestment Act Rating" system; and consumer compliance examinations produce ratings under a "Uniform Interagency Consumer Compliance Rating" system.<sup>1734</sup>

These ratings are typically presented in the annual Report of Examination provided to a financial institution by its primary regulator. They are typically included in a section which lists all of the ratings assigned to the bank during the year. The specialty examination ratings are calculated and presented separately from the CAMELS component ratings which give rise to the bank's overall Composite Uniform Financial Institution Rating. In OCC Reports of Examination, for example, the ratings are usually presented in the following format:

<sup>1733</sup> According to the OCC, typical issues addressed by these specialty examinations are as follows:

- Information Technology (IT) Examinations – evaluate IT-related risks including operations, information security programs, and IT governance processes within supervised financial institutions and technology service providers.
- Trust/Asset Management Examinations – determine if an institution's policies or administration of trust accounts has resulted in a contingent liability or estimated loss that could damage the institution's capital.
- Consumer Compliance Examinations – assess a financial institution's compliance with federal consumer protection laws and regulations.
- Community Reinvestment Act (CRA) Examinations – ensure compliance with the CRA, to include meeting the credit needs of the community that the financial institution serves, including residents of low- and moderate-income neighborhoods.

See OCC website, "Examinations: Overview,"

<http://www.occ.gov/topics/examinations/examinations-overview/index-examinations-overview.html>

<sup>1734</sup> 7/26/2006 OCC Report of Examination of HBUS for the examination cycle ending March 31, 2006, OCC-PSI-00422079, at 4. [Sealed Exhibit]

## Ratings

### Composite Uniform Financial Institution Rating

#### Component Ratings:

- Capital
- Asset Quality
- Management
- Earnings
- Liquidity – Asset/Liability Management
- Sensitivity to Market Risk

### Uniform Rating System for Information Technology

### Composite Uniform Interagency Trust Rating

### Uniform Interagency Consumer Compliance Rating

### Community Reinvestment Act Rating.<sup>1735</sup>

While specialty examination ratings do not automatically or routinely affect either the CAMELS component or composite ratings, if a specialty examination identifies significant problems that are extensive enough to potentially affect the financial condition of the bank, including through the imposition of large civil money penalties, reimbursable violations, or reputational risk, it may contribute to a downgrade of one or more of the CAMELS component ratings which, in turn, may affect the composite rating.<sup>1736</sup> Downgrades to safety and soundness ratings due to problems identified through specialty examinations are not common, however, and are reserved for extreme cases.

**AML Examinations.** An examination focusing on AML compliance is considered a specialty examination. Each of the Federal banking agencies has examiners specially trained to conduct AML examinations. AML examinations do not, however, produce a separate specialty rating, since no interagency agreement has produced an AML rating system. Instead, at Federal banking agencies other than the OCC, AML examination findings are generally addressed as one of the safety and soundness considerations in the Report of Examination (ROE) and included in the development of the bank's safety and soundness ratings. Typically, AML examination results impact the CAMELS management component rating, which may be downgraded if management fails to maintain an adequate AML program.

<sup>1735</sup> Id.

<sup>1736</sup> See, e.g., Federal Financial Institutions Examination Council, "Uniform Financial Institutions Ratings System," 61 FR 245, at 67021 (12/19/1996), <http://www.gpo.gov/fdsys/pkg/FR-1996-12-19/pdf/96-32174.pdf> ("Generally, the impact of specialty area examination findings are reflected in the composite and Management component ratings.").

The CAMELS management component rating is designed to reflect the ability of bank management to adequately identify, measure, monitor, and control problems and manage risks.<sup>1737</sup> Although AML compliance is just one factor in rating the management component, a bank's failure to maintain an adequate AML program can expose a bank to significant reputational risk, remedial costs, and civil money penalties. When such factors are present, Federal bank regulators normally take them into account when assigning the management component rating. If the management component is downgraded, it may also in certain circumstances lower the bank's overall composite rating, with potentially severe impacts on the financial institution's reputation, risk profile, and insurance assessment fees.

In contrast to this approach, which is used by the Federal Reserve, FDIC, and NCUA, the OCC does not treat AML examinations as a safety and soundness matter and does not routinely take AML deficiencies into account when assigning a bank's CAMELS management rating. Instead, the OCC treats AML examinations as a matter of consumer compliance and includes consideration of AML deficiencies when determining an institution's consumer compliance rating. The OCC's approach is explained more fully below.

**Violations of Law.** In their supervisory programs, Federal bank regulators assign a high priority to the detection and prompt correction of violations of law. Such violations may involve statutory or regulatory requirements. Regulators typically list all significant violations of law (as opposed to isolated or technical violations) in the annual Report of Examination provided to a bank's board of directors. The board of directors, in turn, is charged with initiating prompt and appropriate corrective action.

Listing one or more statutory or regulatory violations in a Report of Examination is not uncommon. They may result from bank management's unfamiliarity with the governing law, misinterpretation of the requirements, negligence, or willful noncompliance. The more egregious the nature of the violation, the more severe the repercussions may be. Willful noncompliance with statutory or regulatory requirements, for example, may result in civil money penalties against the bank or individual bank managers as well as removal actions against bank personnel, officers, or directors. Violations are also viewed as significant adverse reflections on bank management capabilities and may lead to a downgrade of the CAMELS management component rating. The underlying causes of the violation play a significant role in that assessment.

<sup>1737</sup> See, e.g., Federal Financial Institutions Examination Council, "Uniform Financial Institutions Ratings System," 61 FR 245, at 67021 (12/19/1996), <http://www.gpo.gov/fdsys/pkg/FR-1996-12-19/pdf/96-32174.pdf>.

**Enforcement Actions.** If a bank regulator becomes concerned about the condition of a financial institution, it has a wide range of informal and formal enforcement actions that could be used to require corrective action. Informal actions are viewed as voluntary actions and include requesting that the financial institution issue a safety and soundness plan, board resolution, or commitment letter pledging to take specific correction actions by a certain date. Another informal action is a memorandum of understanding, which is a signed agreement by both the regulator and the board of directors addressing various actions that the financial institution will take to correct its problem areas. Informal actions are nonpublic and are not enforceable in court. On the other hand, formal enforcement actions are legal proceedings which can include issuing a consent order or a cease and desist order requiring the financial institution to stop an unsafe or unsound practice or to take affirmative action to correct identified problems; imposing a civil money penalty; suspending or removing personnel from the financial institution; suspending or banning personnel from the banking industry; revoking the bank charter; or referring misconduct for criminal prosecution. Formal actions are disclosed to the public and are enforceable in court. Failure to comply with an order can subject the bank to civil money penalties.

With respect to AML enforcement, in July 2007, the Federal bank regulators issued joint interagency guidance entitled, "Interagency Statement on Enforcement of Bank Secrecy Act/Anti-Money Laundering Requirements."<sup>1738</sup> This guidance sought to promote consistent implementation of Section 8(s) of the Federal Deposit Insurance Act and Section 206(q) of the Federal Credit Union Act, both of which require Federal bank regulators to conduct AML examinations and identify AML problems in Reports of Examination. Both sections also require Federal bank regulators to issue a cease and desist order in the event that a bank fails to provide or maintain an adequate AML program. The guidance affirms the Federal bank regulators authority and responsibility for enforcing AML requirements and use of cease and desist order to correct identified problems.

### (3) OCC AML Oversight in General

Because it oversees the largest and most complex banks operating in the United States, some of which operate affiliates in high risk jurisdictions, maintain accounts for high risk clients, or offer high risk products vulnerable to money laundering and terrorist financing, the OCC plays a crucial role in ensuring bank compliance with U.S. AML laws.

<sup>1738</sup> See 7/19/2007 "Interagency Statement on Enforcement of Bank Secrecy Act/Anti-Money Laundering Requirements," reprinted in 8/24/2007 FFIEC BSA/AML Examination Manual, at R-1 to R-7, [http://www.ffiec.gov/bsa\\_aml\\_infobase/documents/BSA\\_AML\\_Man\\_2007.pdf](http://www.ffiec.gov/bsa_aml_infobase/documents/BSA_AML_Man_2007.pdf).

**OCC Organization.** The OCC oversees about 2,000 nationally-chartered banks and savings associations and about 50 U.S. affiliates of foreign-owned banks.<sup>1739</sup> In 2011, the OCC's budget, which is paid for by assessments on the financial institutions it regulates, totaled about \$875 million.<sup>1740</sup> As of 2011, about 3,700 OCC employees were stationed in 66 offices nationwide, organized into four districts known as the Northeastern, Central, Southern, and Western districts, with agency headquarters in Washington, D.C.<sup>1741</sup>

Several groups within the OCC contribute to AML oversight. Examiners with special expertise conduct the actual AML examinations, evaluate bank AML programs, and identify AML deficiencies. They provide their findings to the Examiner-In-Charge at a particular financial institution. At large banks, if AML deficiencies are identified, the Examiner-In-Charge works with the OCC Department of Large Bank Supervision to evaluate the AML examination findings and direct efforts to ensure bank compliance with the law. Bank supervision personnel also work with counsel in the Enforcement and Compliance Department and the Legal Department to determine whether AML enforcement actions are needed and, if so, what actions to take.

During most of the years reviewed by the Subcommittee, the OCC was headed by John C. Dugan who served as the Comptroller of the Currency until his five-year term expired in 2010. In August 2010, he was succeeded by John Walsh who served as Acting Comptroller until April 2012, when Thomas Curry was confirmed by the Senate to serve as the new Comptroller of the Currency. The second in command during most of the years reviewed was First Senior Deputy Comptroller and Chief Counsel Julie Williams. The head of the Department of Large Bank Supervision, which oversees the largest nationally-chartered U.S. banks and U.S. branches of foreign banks was Michael L. Brosnan. One of his chief deputies was Grace Dailey who helped oversee HBUS, until the end of 2010, when she left that post for another, and was replaced by Sally Belshaw. Two other key OCC officials in AML enforcement were Daniel Stipano, Deputy Chief Counsel, and James Vivenzio, senior legal counsel for AML matters. In addition, the Director of the Enforcement and Compliance Department was Richard Stearns.

**OCC Examinations Generally.** Much of the OCC workforce is devoted to conducting or supporting safety and soundness examinations

<sup>1739</sup> See 2011 OCC Annual Report, at 1, chart entitled "National Banking System at-a-Glance," <http://www.occ.gov/publications/publications-by-type/annual-reports/2011AnnualReport.pdf>; OCC website, "About the OCC," <http://www.occ.gov/about/who-we-are/comptroller-of-the-currency/bio-thomas-curry.html>.

<sup>1740</sup> 2011 OCC Annual Report, at 1, chart entitled "OCC at-a-Glance," <http://www.occ.gov/publications/publications-by-type/annual-reports/2011AnnualReport.pdf>.

<sup>1741</sup> 2011 OCC Annual Report, at 1, chart entitled "OCC at-a-Glance," <http://www.occ.gov/publications/publications-by-type/annual-reports/2011AnnualReport.pdf> .Id.; OCC website, "About The OCC," <http://www.occ.gov/about/who-we-are/district-and-field-offices/index-organization.html>.

of the banks regulated by the OCC. In general, for a large bank, the relevant OCC district office assigns an Examiner-in-Charge (EIC) and a team of examiners to work on-site at the bank, on a fulltime basis under a continuous examination program.

Under the OCC's continuous examination program, the EIC is assigned to a particular institution for five years. At the five-year mark, the EIC is then assigned to another bank. The EIC is assisted by a team of examiners that are also assigned to the bank on a full-time basis, but do not have similar five-year term limitations. Members of the examination team may rotate to other banks at various intervals as needed. Regardless, examiners work at the bank year-round and should have a firm and immediate grasp on any issues and problems affecting the bank.

**Supervisory Strategy.** The EIC is responsible for developing an annual supervisory strategy. The supervisory strategy is a prospective work plan for examining the bank, based on perceived risks. The strategy addresses supervisory areas of interest, including what targeted examinations will be conducted throughout the coming year. Targeted examinations address what are called "specialty areas," such as Information Technology, Consumer Compliance, Community Reinvestment Act, and Trust areas. The EIC develops the supervisory strategy, including strategies with respect to the specialty areas with input from examiners, called "team leads," who have lead responsibility for conducting the examinations in those areas. At the OCC, AML compliance is not considered a separate specialty area, but is included within Consumer Compliance specialty examinations. The EIC ultimately presents the annual supervisory plan for approval to the deputy comptroller for Large Bank Supervision at OCC headquarters in Washington.

**Targeted Examinations.** Based on the supervisory strategy, a series of specialized or "targeted examinations" is conducted throughout the year. OCC "Request Letters" are sent to a bank approximately 30 days before the start of each targeted examination. Request Letters give the bank advance notice of the examination and include a list of requested items that the bank should assemble for the examiners to review at the start of the examination.

The examiners then conduct an examination of a specific area of the bank and write a "Conclusion Memorandum" summarizing their findings for the EIC. The examiners may also contribute to any related Supervisory Letter that the EIC sends to bank management and any relevant portion of the annual Report of Examination provided to the bank's board of directors.

Supervisory Letters are used by the OCC officially to inform a bank of the findings of a specialty examination and issues that warrant management's attention. For large banks under continuous examination, the OCC typically uses Supervisory Letters to provide detailed information to bank management about each specialty examination completed throughout the year. In addition to describing the examination findings, the Supervisory Letter can cite an apparent violation of law or a "Matter Requiring Attention" (MRA), meaning it requires the attention of the bank's senior management. Both violations and MRAs require prompt corrective action by the bank.<sup>1742</sup> A Supervisory Letter may also include one or more "recommendations" to enhance bank performance or compliance in a particular area. Under OCC regulation and practice, "recommendations" do not require corrective action by bank management.<sup>1743</sup> OCC personnel told the Subcommittee that the Supervisory Letters written by EICs should accurately reflect the findings and criticisms in the conclusion memoranda written by the examiners.<sup>1744</sup>

Before issuing a Supervisory Letter, the EIC is required to forward a draft of the letter to the OCC's Senior Deputy Comptroller in Washington for review. If the Supervisory Letter cites an AML violation or MRA requiring corrective action, it is referred to the Large Bank Review Committee (LBRC), which is comprised of three senior staff with AML expertise.<sup>1745</sup> The LBRC members are the senior legal counsel with AML expertise from the Legal Department, the Director for Bank Secrecy Act and Money Laundering Compliance, and the Director for Enforcement and Compliance. The LBRC was established in response to problems associated with the Riggs Bank AML examinations nearly ten years ago and is intended to ensure that OCC AML experts review field examiners' work and promote consistency in AML enforcement across large national banks. Until recently, it was optional for the LBRC to have the examiner's Conclusion Memorandum upon which the draft Supervisory Letter is based, but the LBRC has recently begun to require both before it will undertake a review of the draft letter.<sup>1746</sup>

**Report of Examination (ROE).** On an annual basis, for each large bank, the OCC issues a Report of Examination (ROE), summarizing the condition of the bank. The ROE normally includes all of the bank's ratings arising from examinations of the bank's safety and soundness and specialty areas, as well as all cited violations of law and

<sup>1742</sup> Subcommittee interviews of Joseph Boss (1/30/2012) and James Vivenzio (3/15/2012). Mr. Vivenzio told the Subcommittee, "An exam cited with an MRA is a failure" on the part of the bank.

<sup>1743</sup> Id.

<sup>1744</sup> Subcommittee interview of Joseph Boss (1/30/2012) and Elsa de la Garza (1/9/2012).

<sup>1745</sup> Subcommittee interview of James Vivenzio (3/15/2012).

<sup>1746</sup> Id.

significant MRAs. Depending on the circumstances, the issues noted in Supervisory Letters provided to bank management throughout the year may or may not be referenced in the ROE. The EIC sends the ROE with a cover letter to the bank's board of directors so that it has a written record of the regulator's concerns. In addition, on an annual basis, the EIC attends a board meeting and presents the consolidated examination findings contained in the ROE to ensure the Board is fully informed about the bank's ratings, financial condition, and any deficiencies.

**AML Examinations.** Like other Federal bank regulators, the OCC treats AML examinations as a specialty or targeted examination, and employs examiners with specialized AML expertise to conduct them. Upon completing an AML examination, the examiner is required to submit a Conclusion Memorandum to the Examiner-In-Charge of the bank describing the examination findings, any apparent violations of law, and possible recommendations, MRAs, or enforcement actions. The Examiner-In-Charge then sends a Supervisory Letter to the bank summarizing the AML examination findings and presenting any violations, MRAs, or recommendations.

At the end of the year, when the OCC readies the annual Report of Examination (ROE) for the bank and summarizes examination findings made during the year, the OCC does not treat AML deficiencies as a safety and soundness matter. It does not discuss AML problems in the ROE's analysis of safety and soundness issues, nor does the OCC routinely take AML deficiencies into account when assigning the bank a CAMELS component rating for management or its overall composite rating.

Instead, unique in the Federal Government, the OCC subsumes AML issues within its consideration of consumer compliance issues.<sup>1747</sup> The ROE discusses AML compliance in a section entitled, "Consumer Compliance" and combines that discussion with consideration of the bank's compliance with consumer protection and civil rights laws. In addition, the OCC takes AML deficiencies into consideration when assigning a bank's consumer compliance rating, even though the Uniform Interagency Consumer Compliance Rating System does not include AML considerations when specifying how to calculate that rating.

Consumer compliance examinations normally cover a bank's compliance with consumer protection laws, such as laws requiring accurate disclosures of fees and interest rates, understandable mortgage

<sup>1747</sup> See 9/2007 "Comptroller's Handbook – Bank Supervision Process," Appendix D, at 89, [http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/\\_pdf/banksupervisionprocess.pdf](http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/_pdf/banksupervisionprocess.pdf), ("However, the OCC does incorporate into the consumer compliance rating examination findings pertaining to compliance with the Bank Secrecy Act (BSA), anti-money laundering (AML), and Office of Foreign Asset Control (OFAC)."). See also 2006-2010 OCC Reports of Examination for HBUS. [Sealed Exhibits.]



and credit card disclosures, and avoidance of unfair or deceptive practices. They also examine a bank's compliance with civil rights laws, such as prohibitions against discrimination against persons on the basis of race, religion, national origin, or other prohibited categories.<sup>1748</sup> The examinations test, for example, the adequacy of a bank's operating systems to track compliance with consumer protection laws, the documentation it uses for consumer products, and the content of files related to such products as mortgages, consumer loans, and credit cards. Those considerations are key to ensuring bank compliance with consumer protection and civil rights laws, but do not include and have no relevance to compliance with AML requirements to guard against money laundering and terrorist financing.

Like CAMELS ratings, consumer compliance ratings use a scale of 1 to 5, with "1" being the best rating and "5" the worst.<sup>1749</sup> The consumer compliance rating is calculated and presented separately in the OCC's ROE, and typically has no impact on a bank's component CAMELS ratings or its overall composite rating and, thus, no impact on an evaluation of the bank's safety or soundness.<sup>1750</sup> A bank's consumer compliance rating typically comes into play if a bank wants to open a new branch or expand into a new area of consumer lending; the OCC generally will not approve such an application, unless the bank has a consumer compliance rating of 1 or 2, showing that it is treating its customers fairly.<sup>1751</sup> Those considerations are not relevant, however, to AML compliance issues. Additionally, there is no logical reason why poor AML compliance should lower a bank's consumer compliance rating when the two have virtually nothing in common.

An internal OCC review raised these same concerns. In 2005, following the Subcommittee's report on the OCC's inadequate AML oversight of Riggs Bank, the OCC's Quality Management Division issued an internal report evaluating the OCC's AML supervision

<sup>1748</sup> The OCC has identified a long list of relevant laws, including the Truth in Lending Act, Fair Credit Billing Act, Consumer Leasing Act of 1976, Fair Credit Reporting Act, Equal Credit Opportunity Act, Fair Debt Collection Practices Act, and Electronic Fund Transfers Act. See "Comptroller's Handbook **Error! Main Document Only.** – Consumer Compliance Examination," Appendix A, "Uniform Interagency Consumer Compliance Rating System," [http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/\\_paginated/overview/default.htm?startat=over00013.htm](http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/_paginated/overview/default.htm?startat=over00013.htm).

<sup>1749</sup> See "Comptroller's Handbook – Consumer Compliance Examination," Appendix A, "Uniform Interagency Consumer Compliance Rating System," [http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/\\_paginated/overview/default.htm?startat=over00013.htm](http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/_paginated/overview/default.htm?startat=over00013.htm).

<sup>1750</sup> OCC officials told the Subcommittee that, in some circumstances, the consumer compliance rating could be taken into account when evaluating a bank's CAMELS management rating, although that was not typical. Subcommittee interview of James Vivencio (3/15/2012) and Joseph Boss (1/30/2012).

<sup>1751</sup> See, e.g., 12 C.F.R. Section 5.13(a)(2); branch application for national banks, at 7, <http://www.occ.gov/static/licensing/form-branch-relo-app-v2.pdf>; Branches and Relocations, Comptrollers Licensing Manual, at 4, <http://www.occ.gov/publications/publications-by-type/licensing-manuals/branches.pdf>.

program.<sup>1752</sup> That report found that the interagency consumer compliance rating system was not designed to and did not address AML issues. It noted that the rating was “geared to more traditional consumer protection regulations, such as Regulation Z and Regulation B, but is silent relative to BSA/AML compliance issues.”<sup>1753</sup> The report also noted: “Since the consumer compliance rating system was developed as a FFIEC initiative, OCC cannot modify the ratings outside of FFIEC.” The report recommended that the OCC work with the FFIEC to try to change the ratings system to incorporate AML issues, but seven years later, the ratings system still excludes consideration of AML issues, perhaps because no agency other than the OCC attempts to combine consumer compliance and AML concerns into a single rating.

**AML Violations.** In addition to subsuming AML concerns within its consumer compliance rating system, the OCC also has a unique approach to citing AML violations in its Supervisory Letters and Reports on Examination (ROE).

Like other Federal bank regulators, the OCC often includes a list of apparent violations of law in its annual Reports of Examination. Those violations span a wide range of banking laws and regulations, including, for example, consumer compliance concerns.<sup>1754</sup> In the AML area, however, the Subcommittee has learned that the OCC has adopted a practice of limiting the types of AML violations it will cite either in a ROE or Supervisory Letter.

Currently, all Federal bank regulators, including the OCC, will cite an apparent violation of law in a Supervisory Letter or ROE if the regulator determines that a financial institution’s entire AML program has failed. For the OCC, that citation would be an apparent violation of 31 U.S.C. § 5318(h)(1) and the OCC implementing regulation, 12 C.F.R. Section 21.21(b)(1). On the other hand, if the OCC were to determine that a bank failed to comply with one of the four mandated components of an effective AML program – described earlier as internal controls, an AML compliance officer, AML training, and independent testing – the Subcommittee has been told that, contrary to all other Federal bank regulators, the OCC generally will not cite a violation of one of the individualized program components, even though each component has its own statutory basis. For example, if a bank failed to provide adequate AML internal controls, Federal bank regulators other than the

<sup>1752</sup> 5/18/2005 “Bank Secrecy Act/Anti-Money Laundering Supervision,” prepared by OCC Quality Management Division, HSBC OCC 2495056.  
<http://www.aba.com/Solutions/Compliance/Documents/cd8a83ee7a934b4ab75e71a4fae6813aBSAAML.OCCQMD.pdf>.

<sup>1753</sup> Id. at 7.

<sup>1754</sup> 7/26/2006 OCC Report of Examination for HBUS, OCC-PSI-00422079, at 2-3 (citing violations of the Equal Opportunity Act and Consumer Protections for Depository Institution Sales of Insurance regarding disclosures). [Sealed Exhibit.]

OCC would cite the bank for violating 31 U.S.C. § 5318(h)(1)(A). In contrast, the OCC routinely forgoes the citation of violations of the individual AML program components, instead typically designating such a deficiency as a Matter Requiring Attention (MRA) by the bank.<sup>1755</sup>

To examine the difference in the approach of the OCC versus other Federal banking agencies, the Subcommittee reviewed five years of reports compiled by the U.S. Treasury's Financial Crimes Enforcement Network (FinCEN) which, among other matters, track the AML statutory violations cited by the agencies.<sup>1756</sup> Over the five year period from 2007 to 2011, the FinCEN reports show that the OCC conducted about 6,600 examinations and cited pillar violations only 16 times. In comparison, the Federal Reserve conducted about 4,800 examinations and cited pillar violations 159 times. The FDIC conducted about 12,800 examinations and cited pillar violations 714 times. The OCC approach is out of alignment with that of its peers.

Treating the failure of an AML pillar component as an MRA rather than an AML violation sends a more muted message about the importance of the AML deficiency and the need to correct it in a prompt manner. A matter requiring "attention" simply does not have the same urgency as a statutory "violation." In addition, citing a violation of law when one critical component of a bank's AML program is inadequate sends a strong message to management that its AML program is deficient, does not meet minimum statutory requirements, and requires remediation to ensure compliance with all four statutory requirements.

**AML Enforcement Actions at Large Banks.** When the OCC identifies AML deficiencies at a bank, it can use informal or formal enforcement actions to compel the bank to correct the deficiencies and strengthen its AML controls.

Informal actions include nonpublic commitment letters, board resolutions, or memoranda of understanding in which the bank makes written commitments, with fixed deadlines, to take specific actions. To take an informal action against a large bank, an Examiner-in-Charge must obtain the approval of the Large Bank Supervision Department in

<sup>1755</sup> One OCC senior legal counsel specializing in AML matters told the Subcommittee that the OCC "will not cite pillar violations" and instead lists them as MRAs which are not enforceable in court. He said that the OCC uses the same approach when reporting AML examination findings to FinCEN, describing the OCC's reporting as "cleaner" and not "cluttered with component violations" like the other agencies. Subcommittee interview of James Vivencio (3/15/2012).

<sup>1756</sup> See "Federal Banking Agency Bank Secrecy Act Compliance Examination: Consolidated Quarterly Report," (2001-2011), prepared by FinCEN, using data supplied by the OCC, Federal Reserve, FDIC, NCUA and the Office of Thrift Supervision, PSI-FinCEN-04-0063-296 [Sealed Exhibit.]; 7/2012 chart, "Bank Secrecy Act Pillar Violations 2007-2011," prepared by the Permanent Subcommittee on Investigations.

Washington. While these agreements are not enforceable in court, they can provide quick and effective tools to produce reforms. The OCC, however, disfavors the use of informal actions in AML cases, and has taken only eight informal enforcement actions against large banks for AML deficiencies since 2005.<sup>1757</sup>

To take a formal enforcement action against a large bank, such as a Cease and Desist Order, the Examiner-in-Charge must submit a recommendation to the OCC's Washington Supervision Review Committee (WSRC).<sup>1758</sup> The WSRC is comprised of senior managers in the agency and acts as an advising body to the Senior Deputy Comptroller. It was established to promote consistency in the agency's application of formal enforcement actions. To present a recommendation, the Large Bank Supervision Department and the Legal Department prepare pertinent examination information and a memorandum for the WSRC. Counsel from the Enforcement and Compliance Division also participates. The WSRC ultimately determines whether a program violation can be supported and cited, which would also require the OCC to issue a Cease and Desist Order.

According to the OCC, from 2005 to 2011, the OCC issued 43 Cease and Desist Orders against both large and smaller sized banks with AML deficiencies, compared to 2 by the Federal Reserve and 52 by the FDIC, and assessed \$124 million AML-related civil money penalties, accounting for 62% of the total penalty assessments by Federal banking agencies.<sup>1759</sup> At the same time, the statistics also indicate that the OCC is not resolving AML problems at an early stage but, as with HBUS, may be allowing AML problems to accumulate until they necessitate severe enforcement action.

The interagency guidance on AML enforcement provides all Federal banking agencies with guidelines on the use of formal enforcement actions to ensure bank compliance with AML laws, but does not offer any guidance on the use of informal actions. Among other provisions, the guidance states that if a Supervisory Letter contains an identical AML violation or MRA that was not corrected since the prior examination, typically referred to as a "repeat" violation or MRA, the agency must issue a formal enforcement action to require corrective action.<sup>1760</sup> Under a 2004 Memorandum of Understanding between FinCEN and Federal bank regulators, FinCEN must be notified of,

<sup>1757</sup> Subcommittee briefing by OCC legal counsel (7/13/2012).

<sup>1758</sup> See, e.g., "Process for Taking Administrative Enforcement Actions Against Banks Based on BSA Violations," OCC 2005-45, Attachment, Appendix A to OCC 2004-50, OCC-PSI-00176030.

<sup>1759</sup> Subcommittee briefing by OCC legal counsel (7/14/2012).

<sup>1760</sup> See 7/19/2007 "Interagency Statement on Enforcement of Bank Secrecy Act/Anti-Money Laundering Requirements," in the Federal Financial Institutions Examination Council's Bank Secrecy Act/Anti-Money Laundering Examination Manual, Appendix R, at R-4 ("Failure to correct a previously reported problem with the BSA Compliance Program").

among other things, all AML-related formal and informal enforcement actions taken with respect to a particular bank.<sup>1761</sup>

## **B. OCC Oversight of HBUS**

HBUS is located within the OCC's Northeastern District which is currently headed by Deputy Comptroller Toney Bland. The OCC Examiner-in-Charge of HBUS was Anthony DiLorenzo from 2004 until 2008, when his term expired, and he was replaced by Sally Belshaw. Ms. Belshaw served as the HBUS Examiner-in-Charge until December 2010, when she was promoted to Deputy Comptroller for Large Bank Supervision.<sup>1762</sup> The current OCC Examiner-In-Charge at HBUS is Kris McIntire.

### **(1) Chronology of OCC AML Oversight of HBUS**

The OCC has been the primary regulator of HBUS since July 2004, when it inherited oversight of a bank already subject to a formal enforcement action to strengthen its AML program. HBUS has been criticized at times for poor AML controls for over the past decade, but until 2010, the OCC failed to take any enforcement action to compel the bank to implement an effective AML program.

**Inheriting an AML Problem.** Over the past 30 years, HBUS, through its predecessor banks, has changed its bank charter three times, switching between OCC and Federal Reserve oversight in 1980, 1993, and 2004.<sup>1763</sup> The first switch took place in 1980, when HSBC acquired 51% control over Marine Midland Bank in New York. Marine Midland Bank was then a state-chartered bank, a member of the Federal Reserve System, and subject to oversight by both the New York State Banking Department and the Federal Reserve. In connection with the 1980 acquisition, however, it converted its charter to a national bank subject to oversight by the OCC. By 1987, HSBC had assumed 100% control of the bank. In 1990, the OCC downgraded the bank's CAMELS composite rating, which remained unchanged through 1993.<sup>1764</sup> On December 31, 1993, Marine Midland switched back to a state-chartered bank in New York subject to Federal Reserve supervision. After its first examination, the Federal Reserve upgraded its rating.<sup>1765</sup>

<sup>1761</sup> See Memorandum of Understanding between FinCEN and bank regulators, [http://www.ffiec.gov/bsa\\_aml\\_infobase/documents/FinCEN\\_DOCS/Memo\\_Understand\\_Sept04.pdf](http://www.ffiec.gov/bsa_aml_infobase/documents/FinCEN_DOCS/Memo_Understand_Sept04.pdf).

<sup>1762</sup> See 12/13/2010 "OCC Announces Changes to the Its Large Bank Supervision Leadership Team," OCC press release NR 2010-140, <http://www.occ.gov/news-issuances/news-releases/2010/nr-occ-2010-140.html>.

<sup>1763</sup> See the Federal Reserve's National Information Center, [http://www.ffiec.gov/nicpubweb/nicweb/InstitutionHistory.aspx?parID\\_RSSD=413208&parDT\\_END=99991231](http://www.ffiec.gov/nicpubweb/nicweb/InstitutionHistory.aspx?parID_RSSD=413208&parDT_END=99991231).

<sup>1764</sup> See 1/19/1990 and 5/31/1993 OCC targeted examinations. [Sealed Exhibits.]

<sup>1765</sup> See 3/31/1994 Federal Reserve Bank of New York examination conducted jointly with the New York State Banking Department. [Sealed Exhibit.]

Six years later, in 1999, Marine Midland Bank acquired two more banks and renamed itself HSBC Bank USA, N.A. (HBUS). In 2003, HBUS was cited by both the Federal Reserve and New York State Banking Department for maintaining an inadequate AML program.<sup>1766</sup> Regulators cited fundamental, wide-ranging problems, including ineffective monitoring of wire transfers and monetary instruments, ineffective recordkeeping and reporting of currency transactions, inadequate customer due diligence and enhanced due diligence, and a failure to report suspicious activities. The Federal Reserve noted that AML deficiencies identified in prior examinations had not been corrected, that bank management was reactive rather than a proactive with respect to its AML program, and that the compliance function had a lack of influence as evidenced by ongoing, uncorrected problems.<sup>1767</sup> On April 30, 2003, both regulators entered into a formal agreement with the bank requiring it to “upgrade and improve” its AML internal controls.<sup>1768</sup> The agreement required:

- “o Development of a compliance program,
- o An effective system and methodology related to monitoring efforts,
- o A system for evaluating suspicious transactions,
- o A customer due diligence program, and
- o The development and implementation of appropriate risk assessments.”<sup>1769</sup>

On March 22, 2004, while this formal enforcement action was still unfolding, HBUS announced its intention to once more seek a national bank charter from the OCC. On July 1, 2004, after acquiring Republic Bank Delaware, HBUS changed its charter a third time and again became a national bank subject to oversight by the OCC. As a condition to approval of its new national charter, HBUS agreed to comply with the provisions of the 2003 agreement requiring AML improvements. HBUS, thus, began its tenure with the OCC operating under an agreement requiring it to address a host of AML deficiencies.

**Terminating the AML Agreement Despite 30 MRAs.** The OCC produced its first Report of Examination (ROE) for HBUS less than a year later.<sup>1770</sup> The ROE covered examinations conducted through March 31, 2005. It noted as the first Matter Requiring Attention of the bank its obligation to implement the AML requirements in the 2003 agreement and concluded that the bank had made significant progress. The ROE stated that HBUS had already “developed a written Anti-Money

<sup>1766</sup> See 12/31/2002 Federal Reserve Bank of New York examination conducted jointly with the New York State Banking Department. [Sealed Exhibit.]

<sup>1767</sup> Id.

<sup>1768</sup> OCC Report of Examination of HBUS, for the examination cycle ending March 31, 2005, OCC-PSI-00107637, at 10-11 (describing the formal agreement). [Sealed Exhibit.]

<sup>1769</sup> Id. at 10.

<sup>1770</sup> Id.

Laundering (AML) program, including a system of internal controls” and established an “AML Oversight and Control Group ... responsible for maintaining enterprise wide AML policies and procedures, identifying red flags and establishing transaction monitoring criteria.” It stated that the bank had “[i]mplemented controls [that] provide for effective monitoring of various transactions throughout all departments of the bank ... for both non-customers and customers ... designed to identify unusual and/or suspicious activities.” It stated that HBUS had “enhanced monitoring abilities through the Customer Activity Monitoring Program (CAMP) system.” The ROE also stated that HBUS had established a “written Customer Due Diligence program” which included procedures to “ensure the identification and timely, accurate, and complete reporting of all known or suspected violations of law against or involving the bank, to law enforcement and supervisory authorities.” It said that HBUS had also “created risk rating criteria to identify categories of customers whose transactions and banking activities pose heightened risk of money laundering and other illegal activities.” It noted that the bank operated an Investigative Control and Reporting Office and a Financial Intelligence Group to conduct enhanced due diligence.

The ROE concluded: “OCC examiners reviewed compliance with the agreement, and found the bank to be in technical compliance with the requirements.” It said that termination of the formal agreement would be considered following targeted AML examinations of certain high risk areas in the bank.<sup>1771</sup> Given the breadth and depth of the AML problems depicted in the 2003 agreement signed less than a year earlier and the relatively short time that the bank had to correct its AML deficiencies, the ROE’s positive statements were surprising.

Over the next year, until early 2006, OCC AML examiners completed seven AML examinations at HBUS. The examinations reviewed multiple HBUS departments with higher risk activities, including Embassy Banking, Global Banknotes, Foreign Correspondent Banking, wire transfers, and International Private Banking. Each of the examinations identified significant AML deficiencies. The problems included noncompliance with the bank’s AML policies (4 of 7 exams), weak monitoring procedures (5 of 7), weak customer due diligence procedures (5 of 7), inadequate written policies requiring revision (6 of 7), and untrained staff (5 of 7). For example, the examination of the Global Banknotes department found that customer information was missing from a number of files and that a number of banknotes clients were not being monitored at all.<sup>1772</sup> The examination of the bank’s wire transfer operations found that monitoring was being conducted on a

<sup>1771</sup> Id. at 11.

<sup>1772</sup> 6/20/2005 OCC Supervisory Letter to HBUS on Global Banknote Examination, OCC-PSI-00107505. [Sealed Exhibit.]

manual rather than automated basis, and identified one trust account that “had a significant amount of wire transfer activity in a short period of time and involved wire transfers to entities and/or individuals from high risk geographies,” had undergone no monitoring, and whose accountholder had not received an enhanced due diligence review.<sup>1773</sup> The examination of the Embassy Banking department found over a dozen incidents of suspicious activity involving one embassy account over eight months, yet the bank had failed to close the account, despite an HBUS policy requiring closure in that circumstance.<sup>1774</sup> The International Private Bank examination found 540 high risk accounts that needed annual reviews that had yet to be completed; account reviews whose conclusions were not consistently supported; and high risk bearer share accounts whose shares were not under bank control and posed a risk that the bank was unaware of the true account owners.<sup>1775</sup>

When viewed together, the examinations identified systemic AML problems, a situation consistent with the extensive AML enforcement action instituted by the Federal Reserve and New York Banking Department. Many of the problems cited in the OCC examinations, including weaknesses in customer due diligence and monitoring, were prominent features of the 2003 agreement. In response to the AML examination findings, the OCC Examiner-in-Charge sent Supervisory Letters which, together, identified 30 Matters Requiring Attention (MRAs) requiring corrective action by HBUS.<sup>1776</sup> Despite issuing over 30 MRAs in just over 12 months, on February 6, 2006, the OCC

<sup>1773</sup> 1/23/2006 OCC Supervisory Letter to HBUS on Wire Transfer Examination, OCC-PSI-00107522. [Sealed Exhibit.]

<sup>1774</sup> 11/23/2005 OCC Conclusion memorandum “BSA/AML Examination – HSBC USA International Private Bank,” OCC-PSI-01258252; 1/30/2006 OCC Supervisory Letter to HBUS on Embassy Banking Examination, OCC-PSI-00107529. [Sealed Exhibits.]

<sup>1775</sup> 1/31/2006 OCC Supervisory Letter, “International Private Banking BSA/AML Examination,” OCC-PSI-00107537-542. [Sealed Exhibit.]

<sup>1776</sup> The 30 MRAs required corrective action to address weak AML monitoring procedures, weak AML due diligence, inadequate AML training, and inadequate AML policies. Monitoring problems were noted, for example, in all four Supervisory Letters issued in January 2006. See 1/17/2006 OCC Supervisory Letter to HBUS on Foreign Correspondent Banking, OCC-PSI-00000295-301, at 299-300 (Monitoring is weak and is not detecting patterns of activity “below system parameters” and monitoring wire transfers is a “manual process and therefore subject to inefficiencies and potential errors”); 1/23/2006 OCC Supervisory Letter to HBUS on Wire Transfers, OCC-PSI-00107522-528, at 526 (“[T]he effectiveness of automated monitoring through CAMP is diminished in the absence of effective investigations of alerts that the system generates.”); 1/30/2006 OCC Supervisory Letter to HBUS on Embassy Banking, OCC-PSI-00107529-536, at 534 (“Embassy Banking Compliance management must ensure that high-risk and Special Category of Client (SCC) accounts are monitored and reviewed on a consistent and frequent basis.”); 1/31/2006 OCC Supervisory Letter, “International Private Banking BSA/AML Examination,” OCC-PSI-00107537-542, at 540-541 (“Management must establish standards for CAMP alert reviews that require well-documented reasons for conclusions . . . . [E]xisting policies and procedures governing PUPID do not provide for adequate identification, monitoring and controlling of the risk inherent in such activity. . . . [T]here are no procedures in place to ensure activity logs are kept current on a scheduled basis. To effectively manage, monitor and report the potential risks associated with PUPID activity, logs must be revised to distinguish funds transfers payable to the account holder initiating the transfer, from those payable to a third-party non-account holder.”).



determined that the condition of the AML agreement had been met and terminated the agreement.<sup>1777</sup>

**AML Deficiencies Continue.** On July 26, 2006, the OCC provided HBUS with another annual Report of Examination covering the period up to March 31, 2006.<sup>1778</sup> In the section entitled, “Matters Requiring Attention,” the ROE included AML matters as an MRA, but provided this mixed message about the state of HBUS’ AML program:

“During the year, we identified a number of areas lacking consistent, vigilant adherence to BSA/AML policies, and provided management with supervisory letters addressing specific areas in need of strengthening. Bank policies are acceptable. Management responded positively and initiated steps to correct weaknesses and improve conformance with bank policy. We will validate corrective action in the next examination cycle.”<sup>1779</sup>

Later in the report, in the section discussing the bank’s “Consumer Compliance Rating,” the ROE stated that HBUS had “a satisfactory BSA compliance program,” that its controls were generally effective, and “no violations of law were noted.” It also stated: “However, each examination resulted in MRAs, typically non-adherence to internal policies and procedures .... This recurring pattern is listed as a Matter Requiring Attention in this Report of Examination.”<sup>1780</sup> The ROE also criticized an internal group dedicated to testing AML compliance, the Compliance Review Unit, which, according to the ROE, was understaffed, performed weak analysis, and needed to be revamped.

HBUS’ typical response to these examinations was to develop AML policies and procedures in response to the specific AML problems identified by the OCC. Those policies and plans often were narrowly targeted, and later examinations found that bank personnel sometimes failed to implement or comply with them.

A year later, on July 24, 2007, the OCC’s annual Report of Examination contained a more negative assessment.<sup>1781</sup> This report covered examinations conducted through March 31, 2007. The letter transmitting the ROE stated:

“A number of business areas continue to lack vigilant adherence to BSA/AML policies. Supervisory letters issued during the year highlighted a number of thematic deficiencies in the execution of

<sup>1777</sup> 7/26/2006 OCC Report of Examination of HBUS, for the examination cycle ending March 31, 2006, OCC-PSI-00422079, at 5. [Sealed Exhibit.]

<sup>1778</sup> 7/26/2006 OCC Report of Examination of HBUS, for the examination cycle ending March 31, 2006, OCC-PSI-00422079. [Sealed Exhibit.]

<sup>1779</sup> Id. at 2.

<sup>1780</sup> Id. at 12.

<sup>1781</sup> 7/24/2007 OCC Report of Examination of HBUS, for the examination cycle ending March 31, 2007, OCC-PSI-00304077. [Sealed Exhibit.]

BSA/AML policies and procedures at the business level. Management continues to respond positively to correct weaknesses noted, and to improve conformance with bank policy. However, it remains critical that sound policies adopted by the Board and management are executed consistently in the business lines.”<sup>1782</sup>

In the report itself, the section entitled, “Matters Requiring Attention,” included this MRA:

“During the past year, examiners identified a number of common themes in that businesses lacked consistent, vigilant adherence to BSA/AML policies. Bank policies are acceptable; however, the execution of these policies in the various business lines requires strengthening. Management continues to respond positively and initiated steps to improve conformance with bank policy.”<sup>1783</sup>

The MRA, which called for “strengthening” the “execution” of AML policies in “the various business lines,” provided a general instruction to pay more attention to AML compliance.

A second MRA was more specific and issued a warning about the need to strengthen AML controls on HBUS pouch services, meaning bank services to clear monetary instruments from abroad, including bank checks, money orders, and travelers cheques.<sup>1784</sup> The MRA stated that pouch services “facilitate easy movement of funds, and are favored by persons who transfer illegal and terrorist funds.” It noted that pouch services were being provided by multiple HBUS business lines. The ROE described the pouch examination as having “resulted in serious concerns related to weak policies, procedures, systems and controls ... inferior to BSA/AML controls in other areas of the bank.” The ROE also stated that “remedial attention is warranted,” and warned that ongoing inadequate AML controls over pouch activities “could potentially subject the bank to undue reputation risk and/or lead to BSA/AML violations.”<sup>1785</sup>

By the end of 2007, the OCC completed 21 AML examinations, many of which identified serious AML problems.<sup>1786</sup> Many of these examinations identified the same serious problems noted in earlier examinations, some of which cut across business lines. The examinations include AML issues in the London Banknotes office, Corporate and Institutional Banking, Retail Banking, Pouch Services, and Investment Banking. The examination that identified the most serious AML deficiencies, and which was included as an MRA in the

<sup>1782</sup> Id. at 2.

<sup>1783</sup> Id. at 1.

<sup>1784</sup> Id.

<sup>1785</sup> Id. See also the discussion of the bank’s Consumer Compliance Rating, at 12.

<sup>1786</sup> Eight of the 21 examinations were limited to following up on corrective actions promised earlier, all of which were found to have been carried out.

annual ROE, related to pouch services which seemed to be operating without any AML controls. The pouch examination cited insufficient AML policies and procedures, a lack of monitoring for suspicious activities, inadequate AML controls and training, and inadequate independent testing of pouch services for AML compliance.<sup>1787</sup> Examples of potentially suspicious activity included sequentially numbered travelers cheques endorsed by the same exchange house and processed through several cash letters; a transaction that included a starter check for \$105,000; and \$130,000 in sequentially numbered travelers cheques presented in bearer form with the payee line left blank.<sup>1788</sup> OCC examiners initially recommended that a formal enforcement action be taken to effect corrective action in the pouch area, but no formal or informal action was taken.<sup>1789</sup>

The 21 examination reports and the Supervisory Letters that followed identified numerous AML deficiencies, including noncompliance with bank policy, poor monitoring, weak to nonexistent due diligence reviews, inadequate policies requiring revision, and untrained staff. Altogether, from February 2006 to December 2007, the Supervisory Letters identified another 34 AML MRAs, but no violations were identified or enforcement actions taken.

**AML Deficiencies Displaced by Financial Crisis.** On July 15, 2008, the OCC issued its annual Report of Examination for HBUS, summarizing examination activity conducted through March 31, 2008.<sup>1790</sup> Despite referencing a troubling AML examination involving the bank's Embassy Banking department, described below, for the first time since 2004, the ROE did not contain any MRA related to AML concerns. This development may have been due, in part, to the

<sup>1787</sup> 2/23/2007 OCC "Conclusion memorandum for HSBC Middle Market BSA/AML Examination," OCC-PSI-01263216; 4/10/2007 OCC Conclusion memorandum "BSA/AML Examination – HSBC, USA, NA – Pouch Activities", OCC-PSI-00899202 (reviewing pouch activities at the International Private Bank, Domestic Private bank, retail banking, and Payments and Cash Management business units). [Sealed Exhibits.]

<sup>1788</sup> Id. at 208.

<sup>1789</sup> Subcommittee interview of Joseph Boss (1/30/2012), Elsa de la Garza (1/9/2012), and Anthony DiLorenzo (3/22/2012). Upon receipt of the recommendation, the Examiner-in-Charge asked the AML examiners to prepare an analysis of whether the proposed enforcement action, a Cease and Desist Order, met OCC enforcement standards. The AML examiners concluded that, despite the serious AML deficiencies, the problems in the pouch area did not rise to the level of a violation of law and would be applied to a bank with a high composite rating for safety and soundness, and so did not meet OCC standards for issuing a Cease and Desist Order. See 6/14/2007 OCC memorandum, OCC-PSI-01298625; 7/3/2007 OCC memorandum OCC-PSI-00877731. [Sealed Exhibits.] One examiner told the Subcommittee that although the pouch activity did not meet OCC enforcement standards, he felt a Cease and Desist Order was nevertheless warranted at the time. Subcommittee interview of Joseph Boss (1/30/2012). The deputy head of Large Bank Supervision told the Subcommittee that she did not recall being informed about the enforcement recommendation or seeing the Conclusion Memorandum that laid out the problems in the pouch area at HBUS. Subcommittee interview of Grace Dailey (6/15/2012).

<sup>1790</sup> 07/15/2008 OCC Report of Examination of HBUS, for the examination cycle ending March 31, 2008, HSBC OCC 3601119. [Sealed Exhibit.]

deepening financial crisis then sweeping the U.S. financial system, raising questions about virtually every major financial institution. HBUS' AML issues may have been displaced by OCC efforts to analyze the bank's safety and soundness, including each of its CAMELS components. Nevertheless, the ROE did reference ongoing AML concerns at the bank.

The OCC letter transmitting the ROE included this paragraph about AML issues:

"Although BSA/AML internal systems and controls are generally effective, the examination of the Government and Institutional Banking (GIB) operations disclosed a number of significant ... compliance concerns. Management developed a plan to address the issues, and we are presently validating that the actions taken are addressing our concerns."<sup>1791</sup>

Although the ROE contained no MRA related to AML concerns, in the section discussing HBUS' composite rating, the ROE again referenced the examination that uncovered serious AML deficiencies in the GIB department:

"Our examination of BSA/AML practices in the Government and Institutional Banking (GIB) department during the first quarter of 2008 resulted in a number of concerns including: inconsistent adherence to internal policies and procedures, inadequate systems, the need to strengthen controls, and inconsistent monitoring processes. Management is aware of the deficiencies and developed a plan to address the issues. We are in process of validating that the corrective action plan addresses our concerns satisfactorily."<sup>1792</sup>

Although these AML deficiencies were discussed in the composite rating section, there is no indication they affected the rating which remained unchanged from the prior year.

AML issues were discussed a third time in the section of the ROE analyzing HBUS' Consumer Compliance Rating. For the first time, this section included a lengthy discussion of the high AML risks incurred by HBUS' banking operations. The ROE stated:

"BSA/AML examinations were conducted in Middle Market, Government and Institutional Banking, Corporate Trust, Investment Banking, Customer Activity Monitoring Program, and London Banknotes follow-up. ...

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<sup>1791</sup> Id. at 2.

<sup>1792</sup> Id. at 3.

HBUS is the largest Embassy banking services provider. The bank is also active in the precious metals, jewelry, garment, and Middle Eastern carpets industries. HBUS has numerous accounts to Politically Exposed Persons and Money Service Businesses. The bank ranks in the top three banks in CHIPS and SWIFT wire transfer volume, and is a leader in global foreign correspondent relationships. As the U.S. dollar clearing bank for the Global HSBC network, HBUS maintains numerous relationships with institutions worldwide. ... The bank does business with numerous customers in both High Intensity Drug Trafficking Area and High Intensity Money Laundering and Related Financial Crime Area locations. HBUS provides pouch services through several business units. Historically, pouch services are vulnerable to money laundering risk.”<sup>1793</sup>

Despite this recitation of the AML risks facing HBUS, the ROE stated that the bank’s AML controls were “generally effective, with no violations noted.” It also stated that “certain areas within GIB required strengthening.”<sup>1794</sup>

**Embassy Banking Examination.** The ROE’s multiple references to GIB, the Government and Institutional Banking department that housed the bank’s Embassy Banking services, were included, because in January 2008, former GIB employees alerted the OCC to a host of problems in the Embassy Banking unit. HBUS had dramatically increased its Embassy Banking business, after the closure of Riggs Bank and the decision by Wachovia Bank to exit the business.<sup>1795</sup> By January 2006, the bank had over 2,500 embassy accounts with \$485 million of deposits under management,<sup>1796</sup> and the business continued to grow. The former employees described numerous problems, including apparent employee misconduct, inappropriate business transactions, noncompliance with bank policy, inadequate account monitoring, and erroneous and misleading regulatory and internal reports.

Over the next few months in 2008, an OCC examination confirmed the allegations.<sup>1797</sup> The examination found, for example, that GIB had allowed two high risk embassy accounts involving Libya and Saudi Arabia to operate outside of restrictions specified in Memoranda of

<sup>1793</sup> Id. at 13-14.

<sup>1794</sup> Id. at 13.

<sup>1795</sup> See 1/30/2006 OCC Supervisory Letter regarding HBUS Embassy Banking, OCC-PSI-00107529-736, at 529-530; “HSBC to Open D.C. Branch, Pursue Embassy Clients,” *Washington Post*, Terence O’Hara (10/5/2004)(quoting Riggs spokesperson: “As a service to our remaining embassy clients, Riggs is working closely with HSBC to ensure a smooth transition.”), <http://www.washingtonpost.com/ac2/wp-dyn/A7285-2004Oct4?language=printer>.

<sup>1796</sup> 1/30/2006 OCC Memorandum, “4Q05 Embassy Banking Examination,” OCC-PSI-00107529; 1/30/2006 OCC Supervisory Letter to HBUS, OCC-PSI-00107529. [Sealed Exhibit.]

<sup>1797</sup> 10/8/2008 OCC Memorandum, “Royal Embassy of Saudi Arabia (RESA) March 2008 Examination Conclusions,” OCC-PSI-01434609; 4/3/2008 OCC Memorandum “Libyan Relationship Review,” OCC-PSI-01434593; 5/20/2008 OCC Memorandum, “Government and Institutional Banking,” OCC-PSI-00899215.

Understanding (MOU) established for each Embassy relationship. The examination found unacceptable levels of risk, inadequate account monitoring, and suspect transactions. One example involved a \$20 million wire transfer that was variously explained as needed to pay the expenses of Libyan prisoners in the United States and elsewhere, or for “legal expenses and consultation that will lead to the establishment of a bilateral agreement with the US for cooperation on judicial affairs that related to future prisoner transfers.”<sup>1798</sup> The examination reported that when HBUS Compliance asked an Embassy Relationship Manager for information about one of the high risk accounts, it received insufficient explanations and, in some cases, the Relationship Manager took up to four months to obtain client responses.

In addition, the examination found that Embassy Banking had been opening new accounts without notifying HBUS AML Compliance, which was against bank policy and led to unmonitored account activity. The OCC determined that two of five accounts opened for one high risk embassy relationship had not been disclosed to AML Compliance. It found that over 45 letters of credit for other Embassy Banking clients, ranging in amounts from a few thousand dollars to \$3 million, were also undisclosed. Another problem was that Embassy Banking was executing transactions for persons who were not clients – so-called PUPID transactions that were Payable Upon Proper Identification – without logging in some of the transactions and without screening the transaction beneficiaries against OFAC’s SDN list, in contravention of U.S. law. Still another problem was that Embassy Banking personnel had identified multiple instances of suspicious activity involving some accounts, but had not closed the accounts, despite an HBUS policy requiring closure under those circumstances. The OCC also identified a backlog of over 3,000 unreviewed alerts, some dating back to 2007, relating to potentially suspicious transactions in Embassy accounts.

The OCC examiner concluded that GIB’s “AML program is not effective in identifying and mitigating risk, especially considering the nature of its clientele and the types of products and services it provides.”<sup>1799</sup> The examiner recommended issuance of a Cease and Desist Order requiring immediate corrective action and prohibiting new Embassy Banking accounts until AML controls were in place. The OCC decided, however, not to issue a Cease and Desist Order or take any other informal or formal enforcement action with respect to the Embassy Banking accounts.<sup>1800</sup> In May 2008, HBUS submitted an action plan to

<sup>1798</sup> 4/3/2008 OCC Memorandum “Libyan Relationship Review,” OCC-PSI-01434593, at 5.

<sup>1799</sup> 5/20/2008 OCC Memorandum, “Government and Institutional Banking,” OCC-PSI-00899225.

<sup>1800</sup> The AML examiner told the Subcommittee he was not given any reason for OCC’s inaction in this matter, but was simply told there would be no enforcement action. He said it was his understanding that the Examiner-in-Charge had discussed the matter with the deputy head of Large Bank Supervision in Washington before telling him: “Grace said there would be no C&D.” Subcommittee interview of Joseph Boss (1/30/2012). The Examiner-in-Charge told the

the OCC and began addressing the AML deficiencies at GIB. A later examination was conducted to determine whether the GIB commitments were carried out and found that they were. In July 2008, the Report of Examination sent to HBUS acknowledged the AML deficiencies uncovered in Embassy Banking, but did not treat them as a Matter Requiring Attention by the HBUS board.

**AML Deficiencies Continue Amid Law Enforcement Inquiries.**

On July 6, 2009, the OCC sent HBUS the annual Report of Examination covering the period up to March 31, 2009.<sup>1801</sup> Like the prior year's ROE, it contained no Matter Requiring Attention related to AML issues. The letter transmitting the ROE noted, however, that AML concerns were ongoing nonetheless:

"Compliance with BSA/AML remains a high priority and a key reputation risk. As part of the 'compliance transformation project,' this area is also undergoing significant change. The company has high-risk clients and businesses and the current leadership needs to be strengthened. Plans are underway to address this concern."<sup>1802</sup>

This letter was the first to be signed by Sally Belshaw, who had replaced Anthony DiLorenzo as the OCC Examiner-in-Charge at HBUS, upon conclusion of Mr. DiLorenzo's five-year term. It was the fifth in a row to identify AML compliance as a high priority issue.

For the first time, the ROE contained a "Risk Assessment Summary" table which included a reference to AML issues. The table indicated that AML risk was "High," AML risk management was "Satisfactory," and the aggregate AML risk at HBUS was "High" and "Stable."<sup>1803</sup>

Later in the report, in the section discussing the bank's "Consumer Compliance Rating," the ROE stated that HBUS' compliance risk was "high due to the bank's lines of business which offer several products historically associated with money laundering." It repeated much of the language from the last ROE describing the bank's high risk businesses and customers. It also indicated that HBUS needed to strengthen its AML leadership:

"Although the BSA/AML program is effective overall, we recently highlighted the need to strengthen leadership in the area. When the

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Subcommittee that he did not recall talking to a superior about the matter, but thought he "probably did because it was a significant issue." Subcommittee interview of Anthony DiLorenzo (3/22/12). The deputy head of Large Bank Supervision did not recall having a discussion about a Cease and Desist Order involving Embassy Banking at HBUS. Subcommittee interview of Grace Dailey (6/15/12).

<sup>1801</sup> 6/07/2009 OCC Report of Examination of HBUS, for the examination cycle ending March 31, 2009, OCC-PSI-00270034. [Sealed Exhibit.]

<sup>1802</sup> Id. at 2.

<sup>1803</sup> Id.

BSA Director resigned in 2007 the role of the HBUS Compliance Director was expanded to include oversight of the BSA/AML program. The current Compliance Director has been in place since second quarter 2008. In addition to BSA responsibility in the U.S., the Compliance Director also has responsibility for Canada, Mexico and the Securities businesses. We believe that a complex, high-risk institution like HBUS needs a BSA/AML Officer who is highly qualified and experienced and have recommended that such a person be dedicated to the function. A search is underway.”<sup>1804</sup>

The discussion of AML leadership was prompted by the 2007 departure of HBUS’ AML head Teresa Pesce after four years on the job, followed by the departure of the head of HBUS Compliance, Carolyn Wind after seven years on the job. After Ms. Pesce left, Ms. Wind had served as both Compliance and AML head. Leslie Midzain was then hired to serve in both roles as well, serving as the bank’s AML head even though her background was in Canada and she had no U.S. AML experience. In 2010, the OCC would ask for her replacement due to her lack of AML expertise and would also criticize the weak AML leadership shown by the regional Compliance head, Janet Burak. In addition to AML leadership problems, the ROE noted that HBUS Compliance was undergoing a reorganization, and that the Compliance Review Unit, originally dedicated to AML independent testing, was also being reorganized and its mission expanded to other compliance issues.

During 2008, the OCC completed six more examinations, one of which focused on reviewing corrective actions to prior problems. Of the remaining five, one involved additional work on the AML deficiencies at GIB’s Embassy Banking unit.<sup>1805</sup> Another focused on AML issues affecting the Payments and Cash Management (PCM) department which helped provide a variety of cash services to clients, including correspondent accounts.<sup>1806</sup> The PCM examination found fundamental flaws in its AML controls, including inadequate monitoring, poor review of account alerts, and suspicious transactions involving money service businesses. The PCM examination found, for example, that PCM “systems and controls are less than satisfactory and do not provide an appropriate level of monitoring for suspicious and unusual activity for all of the activities in the business unit.” One example involved an account alert which found that a U.S. money service business was sending wire transfers through its HBUS correspondent account to an Ethiopian bank for credit to an account it held at that bank, in effect sending money to itself. The alert was reviewed, PCM personnel

<sup>1804</sup> Id. at 16.

<sup>1805</sup> 8/14/2008 OCC Memorandum, “Government and Institutional Banking Update,” OCC-PSI-00899227; 9/4/2008 OCC Supervisory Letter to HBUS on GIB examination, OCC-PSI-00107607. [Sealed Exhibit.]

<sup>1806</sup> 12/7/2007 OCC Memorandum, “BSA/AML Examination - Payment and Cash Management,” OCC-PSI-01263586. [Sealed Exhibit.]



determined more information was needed, but the alert was closed and the transactions continued.

Similar problems had been identified in a 2006 OCC examination of foreign correspondent banking which resulted in an MRA requiring PCM to conduct a review of its money service business accounts. As a result of the 2008 examination, OCC examiners recommended three MRAs, one of which directed PCM to conduct a review of its money service business accounts, which appears to be a “repeat MRA” from the 2006 examination. Several months later, the OCC Examiner-in-Charge sent a Supervisory Letter to HBUS including the three MRAs, but did not characterize the request for an account review as a “repeat MRA” that would necessitate an enforcement action, instead referring to “PCM’s delay in initiating a special review for Money Services Businesses (MSB) type of entities, as required by a previous MRA, has resulted in increased risk.”<sup>1807</sup>

A third examination in 2008, focused on HBUS Compliance Review Unit (CRU) which was dedicated to reviewing AML compliance at the bank. The examination found its work satisfactory but also directed HSBC’s internal audit unit to test the CRU’s workpapers for reliability and directed the CRU to conduct an immediate review of the PCM department which had not undergone an internal AML review for over three years.<sup>1808</sup> Additional examinations focused on AML issues at Card Services<sup>1809</sup> and Banknotes offices in Singapore and Hong Kong.<sup>1810</sup>

In 2009, the OCC conducted eight more AML examinations. Three followed up on the problems uncovered in connection with HBUS’ pouch activities, Embassy Banking and PCM services.<sup>1811</sup> Additional examinations assessed HBUS’ OFAC compliance<sup>1812</sup> and AML controls involving correspondent banking<sup>1813</sup> and private banking.<sup>1814</sup> Those examinations identified additional AML problems.

<sup>1807</sup> 4/21/2008 OCC Supervisory Letter HSBC-2007-24, “Payment and Cash Management BSA/AML Examination,” OCC-PSI-00107597. [Sealed Exhibit.]

<sup>1808</sup> 4/9/2008 OCC Supervisory Letter to HBUS on CRU examination, OCC-PSI-00107594. [Sealed Exhibit.]

<sup>1809</sup> 2/11/2008 OCC Memorandum, “Card Services Compliance Examination,” OCC-PSI-00938171.

<sup>1810</sup> 6/2/2008 OCC Memorandum, “Singapore/Hong Kong Banknotes Examination,” OCC-PSI-00107603.

<sup>1811</sup> 1/22/2009 OCC Supervisory Letter HSBC-2008-16, “Pouch Service BSA/AML Examination,” OCC-PSI-00107615; 6/24/2009 OCC Supervisory Letter HSBC-2009-10, “Global Institutional Banking BSA/AML Examination,” OCC-PSI-00107628. [Sealed Exhibits.]

<sup>1812</sup> 1/20/2009 OCC Supervisory Letter HSBC-2008-41, “Office of Foreign Asset Control Examination,” OCC-PSI-00000434. [Sealed Exhibit.]

<sup>1813</sup> 3/3/2009 OCC Supervisory Letter HSBC-2008-34, “Correspondent Banking BSA/AML Examination,” OCC-PSI-00107618. [Sealed Exhibit.]

<sup>1814</sup> 3/18/2009 OCC Supervisory Letter HSBC-2008-32, “Private Banking BSA/AML Examination,” OCC-PSI-00000445; 9/19/2008 OCC Memorandum “HSBC BSA/AML Private Bank Exam-File Review-Draft,” OCC-PSI-01274467. [Sealed Exhibits.]

For example, the private banking examination concluded: “HSBC’s Private Bank BSA/AML does not adequately manage the risks associated with DPB-NY/CA [Domestic Private Bank offices in New York and California] and IPB-NY [International Private Bank in New York].”<sup>1815</sup> Supervisory Letters sent to HBUS described the AML problems, some of which had been detected in a 2006 examination of private banking, but made no mention of repeat MRAs that would require an enforcement action.

Altogether in 2008 and 2009, the Supervisory Letters identified 12 more MRAs in the AML field, but no informal or formal enforcement actions were taken. These 12 MRAs were on top of the 71 MRAs identified from 2005 to 2007.

In the spring of 2009, a new development intensified OCC’s focus on AML problems at HBUS. The OCC was contacted by two Federal law enforcement agencies regarding separate Federal investigations into possible money laundering through accounts at HBUS. The first contact, in June 2009, was from the U.S. Department of Homeland Security’s Immigration and Customs Enforcement (ICE) unit investigating possible laundering of illegal drug proceeds.<sup>1816</sup> The second contact, around August or September 2009, was from a U.S. Assistant Attorney General in West Virginia investigating a Medicare fraud.<sup>1817</sup>

Senior OCC officials in Washington arranged to meet with the ICE representatives. On September 1, 2009, the meeting took place in Washington and was attended by the OCC Deputy General Counsel Daniel Stipano, Deputy Controller in charge of Large Bank Supervision Grace Dailey, OCC senior legal counsel with AML expertise James Vivenzio, the OCC AML examiners at HBUS, and the ICE representatives.<sup>1818</sup> After the meeting concluded and the ICE representatives left, OCC personnel continued to discuss supervision of HBUS. According to a memorandum summarizing the meeting, the lead AML examiner at HBUS informed the other meeting participants that, during his tenure at the bank, HBUS had been the subject of 83 AML-related MRAs, and he had twice recommended issuance of a Cease and Desist Order to compel the bank to strengthen its AML controls.<sup>1819</sup>

<sup>1815</sup> Id.

<sup>1816</sup> See 9/29/2009 email exchanges between OCC Jim Vivenzio, OCC Joseph Boss, OCC Teresa Tabor, OCC Sally Belshaw, and others, “HSBC,” OCC-PSI-00928756.

<sup>1817</sup> Subcommittee briefing by OCC (3/15/2012).

<sup>1818</sup> See 9/29/2009 email exchanges between OCC Jim Vivenzio, OCC Joseph Boss, OCC Teresa Tabor, OCC Sally Belshaw, and others, “HSBC,” OCC-PSI-00928756-758.

<sup>1819</sup> 9/1/2009 Memorandum to Files from OCC Examiners Joseph Boss and Elsa de la Garza, OCC-PSI-01416833. See also Subcommittee interviews of Elsa de la Garza (1/9/2012), Joseph Boss (1/30/2012), and James Vivenzio (3/15/2012).

According to the meeting memorandum, Mr. Stipano “stated that he was unaware of the recent history of HBUS and that he wanted a thorough review.”<sup>1820</sup>

After this meeting, the OCC directed its AML examiners to draw up an investigative plan and expand an ongoing AML review to encompass a comprehensive review of the entire AML program at HBUS. On September 3, 2009, the OCC sent a letter to HBUS informing it that a regularly scheduled AML examination of the Banknotes department that started in July and for which field work was completed in August 2009, was being expanded.<sup>1821</sup> Additional staff was added to the AML team.

**Expanded AML Examination.** For the first time since the OCC inherited HBUS from the Federal Reserve, it directed its AML examiners to conduct a holistic review of HBUS’ AML program, instead of focusing on AML issues in particular banking services or departments. The AML examiners quickly found fundamental problems related to the specific AML deficiencies identified over the years. This examination would continue throughout 2010.

In March 2010, the OCC issued its first AML-related Supervisory Letter that cited HBUS for a violation of law, for failing to file Suspicious Activity Reports (SARs) in a timely manner.<sup>1822</sup> The Supervisory Letter stated that its AML examination had found that the bank had a backlog of over 17,000 alerts, in four business units, identifying potentially suspicious activity that had not been investigated to determine whether a SAR should be filed.<sup>1823</sup> The OCC determined that 98% of those alerts were generated in the “High Risk Monitoring Group,” and 14% were six months or older.<sup>1824</sup> The OCC gave the bank a deadline of June 30, 2010, to clear the backlog and instructed the bank to develop a risk-based system for reviewing and resolving those alerts. In addition to the backlog of alerts, OCC examiners had found significant backlogs in the bank’s handling of AML-related subpoenas and Section 314(a), and 314(b) requests for information from other banks, though those items were not specifically discussed in the Supervisory Letter.<sup>1825</sup>

<sup>1820</sup> 9/01/2009 Memorandum to Files from Examiners Joseph Boss and Elsa de la Garza, at OCC-PSI-01416833. [Sealed Exhibit.]

<sup>1821</sup> On 9/21/2009, the OCC sent HBUS a request letter for an extensive amount of new information on 25 Latin America-based institutions. There would be eight additional requests for more information through early February 2010. See 2/6/2010 HBUS email from Janet Burak to Brendan McDonagh, OCC-PSI-00787479.

<sup>1822</sup> 3/10/2010 OCC Supervisory Letter HSBC 2010-03, “Backlog of Monitoring Alerts and Enhanced Due Diligence Requests,” OCC-PSI-00851542. [Sealed Exhibit.]

<sup>1823</sup> Id.

<sup>1824</sup> 4/28/2010 Report of Examination of HBUS, for the examination cycle ending December 31, 2009, OCC-PSI-00899872, at 7. [Sealed Exhibit.]

<sup>1825</sup> See “Background Information on HSBC’s Alert Backlog as of the week of February 8, 2010,” prepared by OCC, OCC-PSI-01358494.

Shortly after delivering the Supervisory Letter, the OCC Examiner-in-Charge for HBUS Sally Belshaw and the head of Large Bank Supervision Grace Dailey met with the HSBC Group CEO Michael Geoghegan and the HNAH and HBUS CEO Brendan McDonough on April 20, 2010. In that meeting, the OCC officials informed the bank officials that the agency had identified serious AML deficiencies throughout the bank. According to a memorandum prepared by Ms. Belshaw summarizing the meeting, the discussion included the following:

He [Mr. Geoghegan] asked when I thought things went bad. Grace and I described the spotty history of the bank relative to BSA/AML compliance. The bank converted to a national charter with a Formal Agreement (Fed) that they addressed. We also noted the regular and frequent citing over the years of MRAs in almost every examination we conducted. In those cases, management reacted to our findings and took corrective action. This, however, culminated in a systemic concern that we ultimately characterized as ineffective management (BSA/AML officer last year and now the compliance program overall). We believe that over the years, the people and program did not advance to keep pace with the risk. Systems enhancements are only now being achieved (and moved up in light of our concerns). Talent left the organization and was not replaced by people with sufficient technical skills to lead. Succession/bench strength for the compliance area is now inadequate. MIS has not evolved to permit early identification of risks/concerns. The backlog issue is a symptom of these management weaknesses....

We discussed several areas in some specificity including HBUS' policies/practices with respect to monitoring of affiliate activity (should be to same, not lesser, standard than other correspondents as is currently the case). We highlighted findings of weakness in KYC in several areas: bank notes, wire activity, domestic & international customers. We highlighted our recent concerns/questions about management's ability to address the backlog problem (and violation) given weaknesses we are seeing in data integrity in reports, quality of alert dispositioning, and the lack of independent review/oversight of that process. Our supervisory letter requires that backlogs be completely corrected by June 30<sup>th</sup>. We emphasized that not only must the number be addressed, but they must be effectively dispositioned (qualified reviewers guided by appropriate policy/process, adequate documentation, appropriate/timely SARs filed), and an ongoing system of controls must be in place to ensure the process is

sustainable. We will be requiring qualified, independent verification of that as part of the process.<sup>1826</sup>

**2010 Report on Examination.** On April 28, 2010, three months earlier than normal, the OCC delivered its annual Report of Examination (ROE) to HBUS, covering the period up to December 31, 2009.<sup>1827</sup> Like the Supervisory Letter, this ROE cited HBUS for violating the Bank Secrecy Act due to its failure to file timely SARs, the only violation listed.<sup>1828</sup> The letter transmitting the ROE stated:

“Perhaps most disconcerting, we have identified significant weaknesses in compliance, particularly in Bank Secrecy Act/Anti-Money Laundering (BSA/AML), that are likely to have costly financial and reputation implications. Management is responding to the concerns we are raising, but was not effective in preventing these weaknesses from becoming serious problems. ... An extended examination is revealing serious breakdowns and violations. We will likely be requiring additional action to address this concern.”<sup>1829</sup>

In addition, for the first time, the ROE discussed HBUS’ AML problems in the context of HBUS’ CAMELS management rating, although the rating remained unchanged from the prior year. The ROE noted that HBUS was the subject of several ongoing investigations that could damage its reputation, and the OCC was “increasingly concerned with weaknesses in compliance (particularly BSA/AML) risk management,” including “the quality of BSA/AML monitoring and compliance.” The ROE stated that the ongoing AML examination “is revealing weaknesses that have impacted our overall assessment of the program and its management.”<sup>1830</sup>

The ROE also discussed the AML problems in the section on HBUS’ Consumer Compliance Rating and disclosed that it was lowering that rating as a result. The ROE stated:

“[W] are lowering our assessment of the quality of compliance risk management from satisfactory to weak .... The high level of BSA/AML/OFAC risk associated with HBUS’ business activities is a significant factor in our assessment. ... In addition to the high level of risk presented by its business activities, HBUS has a high quantity of risk based upon significant indications that the bank is not in compliance with all laws and regulations. ... Based upon our work to date, we have identified deficiencies relating to

<sup>1826</sup> 4/20/2010 OCC Memorandum, “Meeting w/Michael Geoghegan and Brendan McDonough,” OCC-PSI-00905522.

<sup>1827</sup> 4/28/2010 Report on Examination of HBUS, for the examination cycle ending December 31, 2009, OCC-PSI-00899872 [Sealed Exhibit.]

<sup>1828</sup> Id. at 7.

<sup>1829</sup> Id. at transmittal letter.

<sup>1830</sup> Id. at 3-4.

HBUS' transaction monitoring, analysis of customer due diligence information, adherence to the USA PATRIOT Act; and filing of Suspicious Activity Reports (SARs). ... We are changing our assessments of both HBUS' BSA/AML program and its overall compliance management program from satisfactory to weak. These changes are based upon our concerns regarding (1) the lack of effective compliance oversight provided by the head of HNAH/HBUS' compliance department, (2) the ineffective results to date of HBUS' project to implement a new model for its compliance structure and process, and (3) the deficiencies that we have identified to date during our expanded examination of HSBC's Global Banknotes business and the concerns raised by multiple external parties."<sup>1831</sup>

The OCC lowered HBUS' Consumer Compliance Rating even though it did not identify any problems related to bank compliance with consumer protection or civil rights laws. The OCC's actions contravened the interagency agreement on how to calculate this rating, which required a focus on consumer protection and civil rights laws, not AML requirements.

Although its Consumer Compliance Rating was lowered, the bank's safety and soundness ratings remained unchanged. Neither the CAMELS management component rating nor the overall composite rating were lowered. These unchanged ratings meant that the bank would also not incur any added Federal deposit insurance fees, despite its elevated AML risk.

On April 15, 2010, the OCC's Washington Supervision Review Committee approved an Order of Investigation "concerning potential violations of law and unsafe and unsound conduct in connection with the BSA/AML policies and practices of HSBC Bank USA, N.A."<sup>1832</sup> The issuance of the Order was based on the preliminary findings of the expanded AML examination, which by that point had identified evidence of a backlog of alerts that had not been processed for suspicious activity reporting; failure to adequately monitor foreign affiliates; and failure to adequately monitor wire transfer transactions for customers in countries designated "standard" or "medium" risk by the bank.

On September 13, 2010, the OCC issued the 31-page Supervisory Letter described earlier, outlining a long list of significant AML problems at HBUS.<sup>1833</sup> The Supervisory Letter also cited the bank for a

<sup>1831</sup> Id. at 6.

<sup>1832</sup> 04/9/2010 OCC Memorandum, "Order of Investigation – HSBC Bank USA, N.A., New York, NY", OCC-PSI-00899481.

<sup>1833</sup> 9/13/2010 OCC Supervisory Letter HSBC-2010-22, "Bank Secrecy Act/Anti-Money Laundering ('BSA/AML') Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21," OCC-PSI-00864335. [Sealed Exhibit.]

violation of the Bank Secrecy Act statute for failing to maintain an effective AML program. The letter informed HBUS that “the bank’s compliance program and its implementation are ineffective, and accompanied by aggravating factors, such as highly suspicious activity creating a significant potential for unreported money laundering or terrorist financing.”<sup>1834</sup> In addition, the letter stated:

“Since the OCC terminated the Formal Agreement in February 2006, the bank has had a high number of MRAs and the OCC continues to identify serious deficiencies in the bank’s BSA/AML compliance program. Over the past two years, the examination scopes have included many of same areas that are of concern at this examination. The OCC has issued twelve MRAs during this period, many of which address similar issues compared to its current concerns, including the adequacy of compliance leadership, alert management, and monitoring systems.”<sup>1835</sup>

In October 2010, six years after becoming HBUS’ primary Federal regulator, the OCC issued its own formal enforcement action, a Cease and Desist Order requiring corrective action on many of the same problems identified by the Federal Reserve seven years earlier in 2003.<sup>1836</sup>

**Federal Reserve Ratings.** The OCC was not the only Federal banking regulator that examined HBUS. Because HBUS had federally insured deposits, the FDIC acted as a secondary regulator. In addition, the Federal Reserve was responsible for regulating HBUS’ holding company, HSBC North America Holdings (HNAH) as well as an Edge Act Corporation that HBUS owned in Florida. The Subcommittee did not attempt to review the oversight exercised by these two other regulators. The Subcommittee did note, however, that as of 2009, the Federal Reserve Bank of Chicago maintained a lower rating for HNAH’s risk management, in part because of the AML problems at HBUS.

The 2009 Federal Reserve report stated: “[T]he primary driver for the overall rating is the unsatisfactory BSA/AML program. BSA/AML risk is currently the highest inherent Legal and Compliance risk for HNAH.”<sup>1837</sup> The Federal Reserve report stated that the bank’s compliance program had focused “inward on alignment with Group, cost reduction, and centralization without sufficient focus on implementing and maintaining good risk identification, control, measurement, and management processes.”<sup>1838</sup> It also noted that “HNAH’s strategic plan

<sup>1834</sup> Id. at 336.

<sup>1835</sup> Id. at 335.

<sup>1836</sup> See *In re HSBC Bank USA, N.A.*, Case No. AA-EC-10-98, Department of the Treasury Comptroller of the Currency, Consent Order (10/4/2012), OCC-PSI-00904698.

<sup>1837</sup> See Federal Reserve Bank of Chicago report as of December 31, 2009, BOG-SR-001368, at 1, [Sealed Exhibit.]

<sup>1838</sup> Id. at 2.

was to focus on customers and business lines with international connections, which present higher levels of BSA/AML and OFAC risks.” According to the Federal Reserve:

“[T]he significant weaknesses and issues identified by regulators on the BSA/AML program underscores senior compliance management’s inability to self-identify compliance risks and to note significant control deficiencies in a timely fashion. While the inabilities of senior compliance management [are] a primary driver for the downgrade<sup>1839</sup> of board and senior management oversight rating, the lack of a sound risk management function that adequately includes compliance risk is also a contributor.”<sup>1840</sup>

In October 2010, on the same day and in coordination with the OCC, the Federal Reserve issued its own formal enforcement action with respect to HNAH, requiring it to strengthen its “firmwide compliance risk management program,” including with respect to AML compliance, and ensure that HBUS complied with the OCC order.<sup>1841</sup>

## (2) Six Years of AML Deficiencies

An OCC presentation providing an “AML Retrospective (2001-2011)” includes a chart showing that, from January 2005 to March 2010, the OCC issued 85 AML-related Matters Requiring Attention to the HBUS Board of Directors, which was a third more AML-related MRAs than the next closest major bank.<sup>1842</sup> An experienced OCC AML examiner told the Subcommittee: “I thought I saw it all with Riggs, but HSBC was the worst situation I’d ever seen.”<sup>1843</sup>

The following chart summarizes many of the OCC-issued MRAs related to AML problems at HBUS. It shows that the examinations repeatedly revealed critical AML problems across HBUS business units, many of which offered high risk products, had high risk clients, or engaged in high risk activities vulnerable to money laundering and terrorist financing. Twenty-one of the examinations identified problems

<sup>1839</sup> This targeted examination did not result in a downgrade at the overall holding company level.

<sup>1840</sup> *Id.* at 5.

<sup>1841</sup> See *In Re HSBC North America Holdings, Inc.*, Case No. 10-202-B-HC, before the Board of Governors of the Federal Reserve System, Cease and Desist Order Issued Upon Consent Pursuant to the Federal Deposit Insurance Act as Amended (10/4/2012).

<sup>1842</sup> See undated presentation, “BSA Officer Roundtable: Bank Secrecy Act Policy and Legal Update,” by John Wagner, OCC Director of BSA/AML Compliance, and James Vivencio, OCC Senior Attorney for BSA/AML, chart entitled, “BSA/AML MRA: Large Banks: Full Information System Extract (LBIS),” OCC-PSI-01768523. See also Subcommittee interviews of Elsa de la Garza, Joseph Boss, and James Vivencio (confirming HBUS had an unusually high number of MRAs compared to other banks); 9/13/2010 OCC Supervisory Letter HSBC-2010-22, “Bank Secrecy Act/Anti-Money Laundering (‘BSA/AML’) Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21),” OCC-PSI-00864335 at 9 (“Since the OCC terminated the Formal Agreement in February 2006, the bank has had a high number of MRAs”). [Sealed Exhibit.]

<sup>1843</sup> Subcommittee interview of Joseph Boss (1/30/2012).



with the bank's AML monitoring systems, including in its wire transfer, pouch, foreign corresponding banking, international and domestic private banking, retail banking, credit cards, Embassy banking, Banknotes, and Payment and Cash Management operations. Inadequate customer due diligence and client information were similarly identified in multiple business lines and services. Noncompliance with bank policy was another common problem. Inadequate staffing and AML training were also repeatedly identified, as were weaknesses in internal reviews of AML compliance. Later on, weaknesses in AML leadership at the bank were also identified. When AML examiners were allowed to undertake a broader analysis of the AML program, they identified additional fundamental problems involving backlogs, inappropriate assessment of country and client risk, favored treatment of HSBC affiliates, and massive gaps in monitoring.

For more than six years, from July 2004 until April 2010, despite compiling a litany of AML deficiencies, the OCC never cited HBUS for a violation of law, never took a formal or informal enforcement action, and turned down recommendations to issue Cease and Desist Orders targeting particularly egregious AML problems, even though the same problems surfaced again and again. The OCC's failure to compel HBUS to remedy the AML deficiencies repeatedly identified by its examiners over a six-year period indicates that systemic weaknesses in the OCC's AML oversight model require correction.

**Matters Requiring Attention (MRAs) and Recommendations in OCC Supervisory Letters for HSBC Bank USA, N.A.  
January 2005 - July 2009**

# of BSA Exams		Supv. Letter Date	Business Line/Area Examined	# MRAs	# Rec.	Internal Control Pillar Issues						Training Pillar	Independent Testing Pillar	BSA Officer Pillar		
						Bank Not Following Policies	Weak Monitoring Procedures	Weak CDD/EDD Procedures	Insuff. Staff Levels	Backlogs Noted	Policies Need Revision	Staff Needs Training	Independent Testing Problems	BSA Officer Inadeq.	OFAC Issues	Sum of MRAs
1		1/26/2005	4Q04 USA Patriot Act Exam	6	0	x		x			x	x				6
2		6/20/2005	1Q05 Global Banknote Exam	6	0	x	x				x	x				12
3		8/9/2005	Embassy Banking Exam	0	0											12
4		1/17/2006	3Q05 Foreign Corresp. Banking Exam	7	0	x	x	x			x	x				19
5		1/23/2006	3Q05 Wire Transfer Exam	5	0	x	x				x	x	x			24
6		1/30/2006	4Q05 Embassy Banking Exam	4	0		x		x		x					28
7		1/31/2006	3Q05 Intri Private Banking Exam	7	0	x	x	x		x	x	x				35
Provisions of the 2003 Written Agreement were terminated 2/6/2006 with the above similar/systemic findings from the first seven BSA/AML exams.																
8		4/12/2006	1Q06 Domestic Private Banking Exam	3	0		x	x								38
9		4/27/2006	1Q06 GIB Exam	0	1				x			x				38
10		6/14/2006	1Q06 Compliance Review Unit (CRU) Exam	4	0					x			x			42
11		7/13/2006	1Q06 Trade Services Operations	0	3			x			x					42
12		9/26/2006	2Q06 London Global Banknote Exam	3	0	x	x	x				x				45
13		10/19/2006	Retail Services Compliance Exam	1	0		x									46
14		12/1/2006	Metris Exam (Credit Cards)	5	0			x			x					51
15		1/8/2007	Taxpayer Financial Services Compliance Exam	0	2											51
16		3/8/2007	Corporate and Institutional Banking Exam	4	1	x		x			x		x		x	55
17		3/19/2007	3Q06 GIB Exam	3	0		x			x						58
18		3/27/2007	3Q06 Retail Banking Exam	3	7			x	x		x					61
19		3/29/2007	4Q06 CAMP Review	1	0											62
20		5/22/2007	OCC Visit to India	0	0		x									62
21		6/17/2007	CAMP Follow-up	0	0											62
22		6/20/2007	1Q07 Corporate Trust Exam	0	0											62
23		8/6/2007	2Q07 Internal Audit and CRU Follow-up Exam	0	1								x			62
24		8/21/2007	3Q07 London Banknote Follow-up Exam	0	0											62
25		8/21/2007	3Q07 GIB Follow-up Exam	0	0											62
26		9/13/2007	Pouch Services and Middle Market Exam	5	0	x	x				x	x	x			67
27		9/21/2007	Investment Banking Exam	3	0			x								70
28		9/21/2007	Taxpayer Financial Services Follow-up Exam	1	0	x										71
29		10/15/2007	Retail Services Compliance Exam	0	1							x				71
30		2/11/2008	Card Services Compliance Exam	0	3		x				x					71
31		4/9/2008	1Q08 Audit and CRU Exam	2	1								x			73
32		4/21/2008	4Q07 PCM Exam	3	0		x					x	x	x		76
33		6/2/2008	Singapore/Hong Kong Banknotes Exam	0	2											76
34		7/10/2008	Taxpayer Financial Services Compliance Exam	1	0											77
35		9/4/2008	2Q08 and 3Q08 GIB Exam	2	0	x	x	x	x	x	x					79
36		1/20/2009	4Q08 OFAC Exam	0	1											79
37		1/22/2009	3Q08 Pouch Follow-up Exam	0	0											79
38		3/3/2009	4Q08 Correspondent Banking Exam	0	2											79
39		3/18/2009	4Q08 Private Banking Exam	2	1		x				x					81
40		3/18/2009	4Q08 PCM Exam	0	1				x							81
41		5/27/2009	Taxpayer Financial Services Compliance Exam	0	0											81
42		6/24/2009	2Q09 GIB Follow-up Exam	1	3		x				x	x	x			82
43		7/7/2009	Compliance Management Exam	1	0									x	x	83
TOTALS				83	30	10	19	13	8	2	21	11	9	1	1	

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### C. OCC Systemic Failures

The OCC's failure for six years to take action to force correction of fundamental problems in HBUS' AML program allowed those problems to fester and worsen. Five key weaknesses in OCC oversight contributed to its those failures: (1) treating AML deficiencies as a consumer compliance issue instead of a management issue; (2) unnecessarily restricting citations of AML program violations; (3) failing to match narrowly focused AML examinations with broader reviews; (4) failing to make better use of formal and informal enforcement actions in the face of continuing AML problems; and (5) issuing Supervisory Letters that sometimes did not accurately convey the AML problems identified in examinations. AML problems that surfaced even after bank commitments to cure identified problems was also a common thread.

#### (1) Treating AML Deficiencies As A Consumer Compliance Issue

The OCC is the only Federal bank regulator that does not address AML problems within the context of a bank's safety and soundness considerations and ratings, instead treating them as a matter of consumer compliance. This approach raises at least three concerns. First, combining AML and consumer compliance concerns undermines and confuses the consumer compliance rating. AML compliance issues are unrelated to consumer protection and civil rights laws and should have no bearing or impact on a bank's consumer compliance rating. Inserting AML considerations into the rating process also directly contravenes the Uniform Interagency Consumer Compliance Rating System specifying how that rating is supposed to be calculated and what it is supposed to signify.<sup>1844</sup> In the case of HBUS, the OCC ended up lowering its consumer compliance rating in 2010, without citing any evidence that the bank was failing to comply with consumer protection or civil rights requirements.

Secondly, failing to maintain an effective AML program is more properly viewed as a management issue that should contribute to a bank's CAMELS management rating and, ultimately, the bank's composite rating. Federal banking agencies have agreed, for example, that a bank with a "2" CAMELS management rating means that "significant risks and problems are effectively identified, measured,

<sup>1844</sup> See "Comptroller's Handbook – Consumer Compliance Examination," Appendix A, "Uniform Interagency Consumer Compliance Rating System," [http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/\\_paginated/overview/default.htm?startat=over00013.htm](http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/_paginated/overview/default.htm?startat=over00013.htm). Compare with FDIC, <http://www.fdic.gov/regulations/laws/rules/5000-1700.html>; Federal Reserve Bank, <http://www.fedpartnership.gov/bank-life-cycle/topic-index/bank-rating-system.cfm>; Consumer Financial Protection Bureau, <http://www.consumerfinance.gov/guidance/supervision/manual/examinations/>.

monitored, and controlled” by bank management.<sup>1845</sup> In contrast, a bank with a “3” management rating signifies “management and board performance that needs improvement or risk management practices that are less than satisfactory given the nature of the institution’s fiduciary activities.” A 3 rating also means that the “capabilities of management or the board of directors may be insufficient for the size, complexity, and risk profile of the institution’s fiduciary activities. Problems and significant risks may be inadequately identified, measured, monitored, or controlled.”<sup>1846</sup> These descriptions of the significance of the CAMELS management rating are directly applicable to management efforts to ensure an effective AML program.

Interagency agreement on the significance of a bank’s overall composite rating is also compatible with this approach. Federal banking agencies have agreed that a composite rating of “2” means that a bank is “in substantial compliance with laws and regulations,” that “overall risk management practices are satisfactory,” and “there are no material supervisory concerns and, as a result, the supervisory response is informal and limited.”<sup>1847</sup> A “3” composite rating means banks:

“exhibit some degree of supervisory concern in one or more of the component areas. These financial institutions exhibit a combination of weaknesses that may range from moderate to severe; however, the magnitude of the deficiencies generally will not cause a component to be rated more severely than 4. Management may lack the ability or willingness to effectively address weaknesses within appropriate time frames. Financial institutions in this group generally are less capable of withstanding business fluctuations and are more vulnerable to outside influences than those institutions rated a composite 1 or 2. Additionally, these financial institutions may be in significant noncompliance with laws and regulations. Risk management practices may be less than satisfactory relative to the institution’s size, complexity, and risk profile. These financial institutions require more than normal supervision, which may include formal or informal enforcement actions.”<sup>1848</sup>

These categories fit seamlessly with management issues related to AML concerns.

Currently, Federal banking agencies other than the OCC routinely consider AML deficiencies as one factor in assigning a bank’s

<sup>1845</sup> See Uniform Interagency Management Component Ratings: [http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/\\_paginated/banksupervisionprocess/default.htm?startat=bank00108.htm](http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/_paginated/banksupervisionprocess/default.htm?startat=bank00108.htm)

<sup>1846</sup> Id.

<sup>1847</sup> See Uniform Financial Institutions Rating System, discussed in 9/2007 “Comptroller’s Handbook – Bank Supervision Process,” [http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/\\_pdf/banksupervisionprocess.pdf](http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/_pdf/banksupervisionprocess.pdf), at 55.

<sup>1848</sup> Id.

management rating and may downgrade that rating if management fails to maintain an adequate AML program. The management component rating is a reflection of management's ability to adequately identify, measure, monitor, and control problems and significant risks. The failure to maintain an adequate AML program exposes a bank to significant reputational risks, potentially large civil money penalties, and criminal prosecution. When such factors are present, it makes sense for a bank regulator to weigh them when assigning the bank's management rating. If the management component is downgraded, it may also in certain circumstances lower the overall composite rating, with potentially severe impacts on the financial institution's reputation, risk profile, and insurance assessment fees.

In the case of HBUS, after documenting widespread and serious AML deficiencies, citing the bank for two violations of law, noting the potential for large civil money penalties, and criticizing both bank management and the board of directors for failing to provide an adequate AML program, the OCC downgraded the bank's consumer compliance rating, but not its CAMELS management rating. The bank's composite rating was also unaffected. The result is that HBUS executives and directors escaped any CAMELS consequences for their poor AML management.<sup>1849</sup>

A third, related problem is that because consumer compliance is a specialty examination area with its own, separate rating system, a lower consumer compliance rating will rarely impact a bank's composite rating. The OCC Reports of Examination make it clear that the consumer compliance rating is not a contributing factor that has a routine impact on a bank's composite rating. HBUS was also aware that its composite rating was generally insulated from the problems with its AML performance, as indicated in a February 2010 email from the HNAH compliance head Janet Burak to top HNAH and HBUS executives Brendan McDonagh and Irene Dörner. At a time when HBUS was in the midst of an intensifying AML examination which would ultimately lead to a Cease and Desist Order, Ms. Burak wrote:

"I met with the OCC today. ... Sally [Belshaw, the OCC Examiner-in-Charge] also indicated that they are considering downgrading their assessment of Compliance Risk Management ... although [Sally] indicated that if they make that decision it will not impact the Bank's composite CAMELS rating ... and would not likely impact the Management rating component."<sup>1850</sup>

<sup>1849</sup> A related problem is that because the Federal Reserve downgraded HBUS' holding company due to the AML problems at HBUS, HNAH executives ended up incurring lower ratings for HBUS' AML management failures, but HBUS executives did not.

<sup>1850</sup> 2/24/2010 email from HNAH Janet Burak to HBUS Brendan McDonagh and Irene Dörner, HSBC OCC 3405315.

This email demonstrates that bank officials were aware of how the process for rating AML performance had little real impact on the safety and soundness ratings that carried important consequences. It suggests that if AML problems had CAMELS consequences on a routine basis, they might have greater significance for management.

The OCC Reports of Examination on HBUS occasionally discuss the bank's AML problems in the part of the report analyzing its management rating or composite rating, perhaps because the issue is relevant to those discussions. But the OCC confined the impact of the bank's AML problems to lowering HBUS' consumer compliance rating and not its CAMELS management or composite ratings which remained unaffected.

The OCC's peculiar treatment of AML concerns as a consumer compliance issue has multiple negative consequences. National banks that fail to maintain adequate AML programs may end up receiving more favorable safety and soundness ratings than they deserve, because the consumer compliance ratings have almost no impact on their management or composite ratings. They may also receive lower consumer compliance ratings than they deserve for the opposite reason. Another consequence is that the bank's deposit insurance assessments remain at a lower level than they should, as a result of safety and soundness ratings that do not fully reflect their AML risks. Treating AML concerns as a management issue would mitigate those negative consequences and create a stronger incentive for national banks to focus on their AML obligations. To strengthen its AML oversight, the OCC should bring its practice into alignment with all other Federal bank regulators, remove AML considerations from its consumer compliance ratings, and consider AML issues in the context of the CAMELS management component.

## **(2) Restricting Citations of AML Program Violations**

A second peculiarity in OCC AML oversight is its failure to cite violations of law in its Supervisory Letters and annual Reports of Examination when a bank fails to comply with one of the four statutorily mandated components of an effective AML program – described earlier as internal controls, an AML compliance officer, AML training, and independent testing – even though each of the four program components has its own statutory basis.<sup>1851</sup> Instead, the OCC has adopted a practice of not citing violations of the individual AML program components, instead treating any such deficiency as a Matter Requiring Attention (MRA) by the bank.<sup>1852</sup>

<sup>1851</sup> See 31 U.S.C. § 5318(h)(1)(A)-(D).

<sup>1852</sup> One OCC senior legal counsel specializing in AML matters told the Subcommittee that the OCC “will not cite pillar violations” and instead lists them as MRAs which are not enforceable in court. He said that the OCC uses the same approach when reporting AML examination

Although MRAs require corrective action by bank management, they are separate and distinct from violations of law. OCC guidance provides that MRAs should address bank practices that “deviate from sound fundamental principles and are likely to result in financial deterioration if not addressed,” or that “result in substantive noncompliance with laws.”<sup>1853</sup> MRAs are intended to target weak policies and practices before they result in violations, and provide an interim step before finding a bank in violation of the law. At the same time, because MRAs signify matters that require the “attention” of management, they do not carry the same legal weight and urgency as violations of law. While they play an important role in AML oversight by focusing bank officials on emerging AML problems, if they take the place of statutory violations, MRAs can end up misleading a bank about the seriousness of an AML deficiency, delay remedial action, and allow an AML problem to fester. Citing a bank for noncompliance with the law, on the other hand, carries more severe consequences if left unaddressed. It also sends a much stronger message to bank management about the need for prompt corrective action, and lends more weight to any subsequent formal or informal enforcement action in the event the problem continues.

The OCC’s practice of not citing a bank for violating the individual statutory requirements for an effective AML program meant that OCC examiners were effectively limited to using only MRAs to compel reform of an identified problem. In the case of HBUS, OCC AML examiners repeatedly identified instances in which HBUS failed to comply with one or more of the four pillar requirements of an effective AML program. HBUS often responded by addressing some of the narrow problems identified, but not the broader underlying programmatic deficiencies, perhaps because the problems were identified in the more neutral language of an MRA rather than as a violation of law.

**AML Compliance Officer.** In one case, in 2009, the OCC determined that the HBUS AML head was not qualified for the position, a rare personnel decision prompted by the bank’s deteriorating AML program. Having a qualified AML compliance officer is one of the four critical requirements of an effective AML program and is mandated by

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findings to FinCEN, describing the OCC’s reporting as “cleaner” and not “cluttered with component violations” like the other agencies. Subcommittee interview of James Vivenzio (3/15/2012). As indicated earlier, annual reports compiled by FinCEN show that, for the five year period from 2007 through 2011, OCC examiners cited only 16 pillar violations in more than 6,600 AML examinations. That total represents more than 10 times fewer violations than the nearest Federal bank regulator, despite the OCC’s having conducted nearly 1,800 more AML examinations. See 2007-2011 Federal Banking Agency Bank Secrecy Act Compliance Examination, “Consolidated Quarterly Reports,” PSI-FinCEN-04-0063-296. [Sealed Exhibit.]  
<sup>1853</sup> OCC’s “Examiner’s Guide to Problem Bank Identification, Rehabilitation, and Resolution,” page 24. <http://www.occ.gov/publications/publications-by-type/other-publications-reports/prbnkgd.pdf>

statute and regulation.<sup>1854</sup> An OCC AML examiner wrote the following about the problem:

“Over the past three years, HBUS has had three BSA/AML Officers. Ms. Lesley Midzain is the current Board designated BSA/AML Officer for HBUS. She has held this position since April 2008. She has limited BSA/AML knowledge and industry experience and is not considered qualified for the position of BSA/AML Officer. This finding is based on numerous interviews by both OCC HSBC resident staff and other OCC large bank staff. She has not enhanced her knowledge of U.S. law related to BSA/AML through formal training, other than internal web based training. It should be noted that even with limited knowledge of U.S. law and regulation, Ms. Midzain has assumed responsibility for both BSA/AML and Compliance.

We communicated to the HBUS President and to Ms. Janet Burak, Chief Compliance Risk Officer that Ms. Midzain does not possess the technical knowledge or industry experience to continue as the BSA/AML Officer. Ms. Midzain’s knowledge and experience with BSA/AML risk is not commensurate to that of other BSA/AML positions held at other large national banks.”<sup>1855</sup>

The FFIEC AML Examination Manual states that “the appointment of a BSA compliance officer is not sufficient to meet the regulatory requirement if that person does not have the expertise, authority, or time to satisfactorily complete the job.”<sup>1856</sup> The OCC viewed HBUS as a large complex financial institution with numerous high risk aspects that required a fully qualified AML expert to administer the bank’s AML program. To express the urgent need for the bank to hire a qualified AML director, the OCC could have cited HBUS for violating the law, but chose instead to issue a Supervisory Letter listing the issue as an MRA.<sup>1857</sup> The bank responded by keeping the targeted official as its head of compliance, hiring a new AML director, and requiring that new AML director to report to the compliance head with no AML expertise. The new AML director left after about nine months.<sup>1858</sup>

**AML Internal Controls over Pouch Services.** In another instance, in January 2007, an OCC examination identified serious AML

<sup>1854</sup> See 31 U.S.C. § 5318(h)(1)(B) and 12 C.F.R. Section 21.21(c)(3).

<sup>1855</sup> 5/15/2009 OCC Memorandum, “Compliance Management Exam,” OCC-PSI-01438115.

<sup>1856</sup> 4/29/2012 FFIEC BSA/AML Examination Manual, “BSA/AML Compliance Program – Overview – BSA Compliance officer,” at 36,

[http://www.ffiec.gov/bsa\\_aml\\_infobase/documents/BSA\\_AML\\_Man\\_2010.pdf](http://www.ffiec.gov/bsa_aml_infobase/documents/BSA_AML_Man_2010.pdf).

<sup>1857</sup> 7/7/2009 OCC Supervisory Letter 2009-01 “Compliance Management Examination,” OCC-PSI-00107631.

<sup>1858</sup> 6/14/2006 OCC Supervisory Letter HSBC-2006-16, “Compliance Review Unit Examination,” OCC-PSI-00000341 (deeming problems with the independent testing pillar component inadequate to justify citing a legal violation)). [Sealed Exhibit.]



problems with HBUS' pouch services, which appeared to be operating with virtually no compliance with AML standards. Pouch services involve clearing U.S. dollar monetary instruments such as travelers cheques, bank cheques, and money orders. The AML problems included a lack of monitoring for suspicious activity, insufficient policies and procedures, and a lack of AML controls. As a result, the OCC broadened its examination to pouch services at other HBUS business units, including the PCM, International Private Banking, Domestic Private Banking and retail banking departments. That examination uncovered additional significant AML deficiencies that had been identified in examinations of other business lines, involving pillar program components such as lack of AML internal controls, training, and independent testing, with systemic implications.<sup>1859</sup> The examination concluded with respect to HBUS pouch services:

"The results of this examination combined with the history of past examinations (i.e. significant number of MRAs) are an indication that program goals and objectives have not been met. The board needs to establish a program with defined elements for policies and procedures, systems and controls, training and independent audit to ensure unwarranted risk is being identified, monitored and mitigated to an acceptable level."<sup>1860</sup>

The OCC examiners recommended that a formal enforcement action be brought against the bank to compel immediate correction of the problems in pouch services. However, after researching OCC standards for bringing enforcement actions, the examiners determined that, to issue a Cease and Desist Order, the agency was required, in part, to cite a violation of law.<sup>1861</sup> Although OCC written guidance states that

<sup>1859</sup> 4/10/2007 OCC Memorandum "BSA/AML Examination – HSBC, USA, NA – Pouch Activities," OCC-PSI-00899202 at 202 and 204 (reviewing pouch activities at the International Private Bank, Domestic Private bank, retail banking, and Payments and Cash Management business units).

<sup>1860</sup> Id. at 9.

<sup>1861</sup> 6/14/07 OCC Memorandum from Joseph Boss to Anthony Diloranzo, "Pouch Exam," OCC-PSI-01298625; 7/3/07 OCC memorandum from Elsa de la Garza to Anthony Diloranzo, "BSA/AML Examination – HSBC, USA, NA – Pouch Activities," OCC-PSI-00877731. See also OCC Policies and Procedures Manual 5310-3 (Rev). The June 14, 2007 memorandum described the OCC's enforcement standards as follows:

"There are two types of enforcement actions prescribed by the OCC. They are 'informal actions' and 'formal actions.' PPM 5310-3 (Rev.) describes the criteria for considering whether or not an enforcement action should be taken against a financial institution. Generally, the nature, extent, and severity of the bank's problems will dictate the necessity for an action. The nature, extent and severity of a bank's problems can range from identified weaknesses that are considered narrow in scope and correctible to significant and substantial problems and weaknesses that jeopardize the safe and sound operation of the bank. In all instances a number of other factors must be taken into consideration before the imposition of an action. Some of those factors are:

- Overall rating of the financial institution.
- Financial condition of the financial institution.
- Past cooperativeness of management.

one criteria for a formal enforcement action is whether: “[t]he bank lacks a BSA compliance program that covers one or more of the required program elements (internal controls, training, audit, responsible personnel),” OCC personnel told the Subcommittee that the OCC had interpreted this language to allow a violation of law to be cited only for a complete program failure, and not when a single pillar or even multiple pillars of an AML program are inadequate.<sup>1862</sup> The examiners determined that they could not conclude that HBUS’ entire AML program was ineffective at that time. Accordingly, despite the significant AML deficiencies found in connection with HBUS pouch services, the OCC examiners concluded they could not cite a violation of law and so withdrew their request for a formal enforcement action. Instead the OCC included a single MRA on pouch services in a Report of Examination sent to the bank in July 2007,<sup>1863</sup> and five MRAs in a Supervisory Letter sent to the bank two months later.<sup>1864</sup>

The OCC’s decision not to cite violations of law or take formal or informal enforcement action to correct severe AML deficiencies that contravene key AML statutory requirements makes no sense. An effective AML oversight effort must be able to act in just such circumstances, and premise an enforcement action on any statutory requirement, including that financial institutions have AML internal controls, an AML compliance officer, AML training, and independent testing, without having to find that virtually all four statutory requirements are being violated at the same time.

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- Management’s ability and willingness to correct identified problems in appropriate timeframes ....

The examiner also identified the standards used to assess whether or not a violation may be cited:

“As stated earlier, in order for the OCC to take any form of enforcement action, certain criteria must be considered. This also applies in considering citing a violation under 12 CFR 21.21. For citing a violation of 12 CFR 21.21 the following must be evident:

- The bank lacks a BSA compliance program that covers one or more of the required program elements (internal controls, training, audit, responsible personnel);
- Fails to implement a written BSA compliance program;
- Exhibits significant BSA compliance program deficiencies coupled with aggravating factors such as evidence of widespread, blatant structuring or money laundering, insider complicity, repeat failures to file currency transaction reports or suspicious activity reports, or other substantial BSA violations; or
- Fails to respond to supervisory warnings concerning significant BSA compliance program deficiencies.”

<sup>1862</sup> Subcommittee interviews of OCC James Vivencio (3/15/2012), Joseph Boss (1/30/2012), and Elsa de la Garza (1/9/2012).

<sup>1863</sup> 7/24/2007 OCC Report of Examination of HBUS, for the examination cycle ending March 31, 2007, OCC-PSI-00304077. [Sealed Exhibit.]

<sup>1864</sup> 9/13/2007 OCC Supervisory Letter HSBC-2007-01, “Pouch Services and Middle Market,” OCC-PSI-00000391. [Sealed Exhibit.] One examiner informed the Subcommittee that, even though they determined the AML deficiencies in HBUS’ pouch services did not meet the OCC’s enforcement guidelines, he still felt that an enforcement action should have been initiated. Subcommittee interview of Joseph Boss, (1/12/12 and 1/13/2012).

Federal bank regulators other than the OCC routinely cite violations of law when a bank fails to comply with one or more of the pillar components of an AML program.<sup>1865</sup> By declining to do the same, the OCC is diluting the importance of the four components; it is essentially sending a message that a bank can lack one or more of the components as long as its entire AML program is not compromised. In addition, by restricting itself to MRAs rather than citations of legal violations, the OCC is unnecessarily diluting its ability to send a strong message that a bank needs to promptly correct a program element, such as an inadequate AML compliance officer or a set of missing AML controls. By limiting its examiners to using MRAs instead of citing statutory violations, the OCC is, in effect, allowing particular problems to fester, as happened in the HBUS case. In addition, by restricting citation of individualized program violations, the OCC is impairing the ability of examiners to pursue formal enforcement actions, which is exactly what happened in the case of the HBUS pouch activities.

Finally, failing to identify violations of laws and regulations may mislead or confuse bank management. Violations are addressed prominently in the Reports of Examination and Supervisory Letters. A bank's directors and managers should be aware of apparent violations of law, given their potentially punitive nature and the bank's responsibility to initiate appropriate corrective action. Violations that are instead reduced to MRAs may mislead a bank by omitting references to specific laws or regulations; downplay the importance of the targeted activity; and insulate the bank's ratings from downgrades that would spur corrective action. Examiners evaluate bank ratings, including the CAMELS management rating and its consumer compliance rating on a number of factors, including management's compliance with laws and regulations, its responsiveness to previously reported violations of law, MRAs, and audit findings. Removing violations from that equation enables a bank to obtain more favorable ratings than it may deserve. To strengthen its AML oversight, the OCC should bring its practice into alignment with all other Federal bank regulators and allow examiners to cite violations of law when a bank fails to comply with one or more of the four statutorily mandated components of an AML program.

### **(3) Using Narrowly Focused Exams**

A third AML oversight practice of concern involves the use of narrowly focused AML examinations that don't also include an examination of a bank's overall AML program. At HBUS, the OCC designed an AML supervisory strategy to examine the institution over a three year cycle using targeted examinations. HBUS had 32 different business units with varying degrees of AML risk, all of which were to be

<sup>1865</sup> See 2007-2011 Federal Banking Agency Bank Secrecy Act Compliance Examination, "Consolidated Quarterly Reports," PSI-FinCEN-04-0063-296. [Sealed Exhibit.]

examined. The plan called for business units with the highest AML risks to be examined first. According to the examiners, the mandate was to examine all 32 business units over a three-year cycle, taking 8 to 10 weeks to examine a business unit from start to finish, using Supervisory Letters to communicate examination results.<sup>1866</sup> According to the plan, OCC examiners would not return to a previously examined area until it had examined all 32 business units, and the adequacy of management's corrective actions for any MRAs would be reviewed once the entire institution had been examined.

The OCC had to depart from this plan given the significant AML risks uncovered at some business units.<sup>1867</sup> In addition, with only two full-time AML examiners dedicated to HBUS, and given the complexity, breadth, and volume of its high risk activities, the OCC had difficulty meeting the three-year objective but strived to achieve it.<sup>1868</sup> The result was a series of narrowly focused, targeted examinations. As each examination concluded, a Supervisory Letter was issued with MRAs or recommendations addressing the AML issues at each specific business unit.

This examination approach, which failed to provide any mechanism for also taking a holistic view of the bank's AML program, raised at least three issues in the HBUS setting: it impeded understanding of fundamental problems with the bank's AML program and allowed systemic problems to fester, it required duplicative efforts, and it made verification of corrective action more difficult. First, the narrow focus of the individual examinations at HBUS made it difficult for OCC examiners to understand the bank's AML program as a whole, to detect systemic problems, or make the case for correcting them. Instead, the OCC continued to review individual business units on a serial basis, addressing the AML problems uncovered in each examination. As a result, the OCC requested and HBUS provided narrow corrective actions, allowing more systemic problems to go unaddressed for years. In addition, it required OCC examiners to address similar AML problems in multiple business units on a repetitive basis.

**HSBC Affiliate Issues Missed.** The limitations of this approach can be seen in the way in which targeted reviews of key bank areas, such as correspondent banking and the Payments and Cash Management (PCM) department, missed major AML deficiencies involving HSBC affiliates. It was only in 2010, when OCC AML examiners were

<sup>1866</sup> Subcommittee interview of Joseph Boss (1/30/2012), and Elsa de la Garza (1/9/2012).

<sup>1867</sup> The OCC revisited, for example, the Global Banknotes unit in 2005, 2006, 2007, 2008, and 2009 and targeted exams of Embassy Banking in 2005, 2006 (three times), 2007, 2008, and 2009.

<sup>1868</sup> AML examiners told the Subcommittee that two additional full time AML examiners were needed to meet the three-year cycle at HBUS, but that staff dedication would have been disproportionate to AML examination staffing at other large national banks. While they were assisted at times by other examiners, the vast bulk of the AML examinations at HBUS were carried out by two OCC AML examiners.

allowed to take a broad-based review of HBUS' AML program, that the examiners focused on the fact that HSBC affiliates played a large role in HBUS' correspondent banking and PCM businesses, but were not subjected to the same AML controls as other clients. The OCC examiners discovered, for example, that HBUS did not conduct any due diligence review of HSBC affiliates or attempt to evaluate their AML risks.<sup>1869</sup> The OCC examiners also discovered that HBUS had stopped monitoring all banknotes business with HBSC affiliates for a three-year period, from mid-2006 to mid-2009, even though those transactions involved billions of dollars of cash and high risk countries like Mexico.<sup>1870</sup> The OCC also learned that HBUS failed to conduct routine account monitoring for dozens of affiliates located in lower risk countries. Still another problem was that OCC examiners determined that HBUS was using an inappropriate process to assess country risk, and was assigning low risk ratings to countries such as Mexico, that should have been designated high risk. Narrowly focused exams, without more, simply didn't identify affiliates as an important AML concern that cut across multiple business lines.

**AML Staffing Issues Fragmented.** A second example involves a series of three AML examinations conducted by the OCC in early 2009, disclosing insufficient staffing to conduct AML monitoring activities in three critical business units, OFAC compliance, Correspondent Banking and the Payments and Cash Management (PCM) department. OCC examiners looked at each business unit individually and the Examiner-in-Charge issued three different Supervisory Letters that questioned the bank's staffing levels and resource commitment in each unit for AML purposes.<sup>1871</sup> By conducting three different examinations with no overarching analysis of AML staffing issues across the bank, the OCC failed to identify inadequate AML staffing as a systemic issue and deal with it in an efficient and effective basis. Instead, each Supervisory Letters focused on a single business line or functional area under review, with no cross references to the other areas having the same problem, at the same time. The recommendations contained in two of the Supervisory Letters, issued in March 2009, contained nearly identical

<sup>1869</sup> See 9/13/2010 OCC Supervisory Letter HSBC-2010-22, "Bank Secrecy Act/Anti-Money Laundering ('BSA/AML') Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21)," OCC-PSI-00864335. [Sealed Exhibit.]

<sup>1870</sup> In the summer of 2009, OCC examiners learned for the first time that affiliates' banknotes activity was not monitored when examining banknotes activity involving an HSBC affiliate in Mexico. The key law enforcement meeting took place the next month, and the banknotes examination was then expanded to look at other AML issues. The banknotes monitoring problem was included in the Supervisory Letter issued a year later identifying a host of AML problems at HBUS. See 8/12/2009 OCC memorandum, "Banknotes Issues," OCC-PSI-00917881-882.

<sup>1871</sup> 1/20/2009 OCC Supervisory Letter HSBC-2008-41, "Office of Foreign Asset Control Examination," OCC-PSI-00000434; 3/3/2009 OCC Supervisory Letter HSBC-2008-34, "Correspondent Banking BSA/AML Examination," OCC-PSI-00107618; 3/18/2009 OCC Supervisory Letter HSBC-2008-40 "Payment and Cash Management BSA/AML Examination," OCC-PSI-00107624. [Sealed Exhibits.]

wording, including the same misspelled word.<sup>1872</sup> As a result, the staffing issues were addressed in a fragmented manner in three different recommendations rather than in a single MRA focusing on the broader problem.

It was not until 2010, after the OCC directed its AML examiners in September 2009, to undertake a more holistic analysis of HBUS' AML program that staffing was examined in a broader way. On March 3, 2010, an OCC Supervisory Letter discussing the discovery of an HBUS backlog of over 17,000 unreviewed alerts noted that staffing concerns had been raised three times in 2009, and identified it as a Matter Requiring Attention by the HBUS Board:<sup>1873</sup>

"In the past, HSBC has had other backlogs, and we have expressed concerns over the course of our supervision about the levels of staffing and the qualifications of personnel assigned to complete reviews. ...

In three Supervisory Letters last year, we expressed concerns about the levels of staffing dedicated to BSA/AML/OFAC compliance. These letters include the supervisory letter issued on January 20, 2009 at the conclusion of our OFAC examination, the supervisory letter issued on March 3, 2009 at the conclusion of the correspondent banking examination, and the supervisory letter issued on March 18, 2009 at the conclusion of the Payment and Cash Management examination."<sup>1874</sup>

Even then, however, the MRA on staffing was narrowly targeted: "Management must ensure that a sufficient number of qualified professionals are engaged to address the 2,488 alerts within the High Risk Monitoring Unit that were generated six or more months ago." Six months later, when the OCC concluded its broad-based examination of the HBUS AML program as a whole and issued a 31-page Supervisory Letter analyzing key problems, inadequate and unqualified AML staffing was finally presented as a systemic problem across the bank.<sup>1875</sup>

**We Didn't Know What We Had.** One of the OCC AML examiners immersed in the HBUS AML examinations for years told the Subcommittee that, upon learning of various law enforcement concerns about HBUS in September 2009, "we'd been doing all of these targeted

<sup>1872</sup> Compare 3/3/2009 OCC Supervisory Letter HSBC-2008-34, "Correspondent Banking BSA/AML Examination," OCC-PSI-00107618, at 619, with 3/18/2009 OCC Supervisory Letter HSBC-2008-40 "Payment and Cash Management BSA/AML Examination," OCC-PSI-00107624, at 625. [Sealed Exhibits.]

<sup>1873</sup> 7/7/2009 OCC Supervisory Letter HSBC-2010-03, "Backlog of Monitoring Alerts and Enhanced Due Diligence Requests," OCC-PSI-00851542. [Sealed Exhibit.]

<sup>1874</sup> Id.

<sup>1875</sup> 9/13/2010 OCC Supervisory Letter HSBC-2010-22, "Bank Secrecy Act/Anti-Money Laundering ('BSA/AML') Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21)," OCC-PSI-00864335, at 337-338. [Sealed Exhibit.]

examinations and we didn't know what we had."<sup>1876</sup> It apparently took that jolt from law enforcement for OCC senior personnel to authorize the OCC AML examiners to develop a broad-based plan to look at the HBUS AML program as a whole, tie various problems together, and identify the most important AML deficiencies requiring correction. While the narrowly focused AML reviews were important to examine particular business units and identify specific issues within those offices, such examinations were incomplete and ineffective without a broad-based look at the bank's AML program as a whole to identify fundamental and cross-cutting issues critical to an effective AML effort.

Still another problem created by the narrowly focused AML examinations was that they complicated efforts by OCC examiners to verify that corrective actions mandated in OCC MRAs were implemented before closing out an MRA. One issue was that examiners weren't supposed to return to re-examine the relevant business unit until much later, theoretically after completing a three-year review of all 32 HBUS units. In reality, the examiners had to ignore that aspect of the examination plan to verify that corrective action was taken. But even then, validation of the effectiveness of the remedies often required duplicative, repetitive efforts since many of the same problems had to be analyzed in multiple, individual business units. In addition, while HBUS and the OCC examiners were focused on AML problems in individual business lines and services, fundamental problems began to build up, including backlogs of unreviewed alerts, collections of unmonitored accounts, and overly favorable treatment of HSBC affiliates.

The HBUS case history provides ample evidence that a stovepipe AML supervisory strategy that focuses solely on serial examinations of individual business lines or services without also examining a bank's AML program as a whole creates a fragmented and inefficient view of a bank's AML program, wastes resources, encourages piecemeal corrective actions, fails to identify fundamental problems which are allowed to fester, and diminishes the usefulness of AML examination findings and corrective actions. To strengthen its AML oversight, the OCC should require its AML examiners to combine narrowly focused AML examinations with at least an annual examination of key elements of the bank's AML program as a whole.

#### **(4) Failing to Use Enforcement Actions**

The HBUS case history, like the Riggs Bank case history before it, betrays an ongoing reluctance by the OCC to use either informal or formal enforcement actions to compel AML improvements, even when a bank is cited for years for significant AML problems.

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<sup>1876</sup> Subcommittee interview of Joseph Boss (1/30/2012).

The OCC identified serious AML deficiencies at HBUS for six years in a row, with the most AML-related MRAs of any bank it supervised, without considering or initiating a nonpublic, informal enforcement action. The reluctance to use informal enforcement actions appears to be a cultural preference rather than the result of any guidance or policy. As mentioned earlier, the OCC disclosed to the Subcommittee that it has taken only eight informal enforcement actions against large banks for AML deficiencies since 2005.<sup>1877</sup> This approach is especially disconcerting in the HBUS case, since the bank expressed a willingness to work with the regulator to implement reforms. Informal remedies – which include requesting that the financial institution issue a safety and soundness plan, board resolution, commitment letter, or memorandum of understanding pledging to take specific correction actions by a certain date – offer useful tools that provide an interim step before a formal enforcement order that is public and carries legal penalties. These tools can be effective, but were not even considered by the OCC in the HBUS AML context.

The HBUS case history also discloses a reluctance on the part of the OCC to use formal enforcement actions to correct AML deficiencies. Two examples involve AML examiners' who twice recommended issuing a Cease and Desist Order against HBUS after finding severe AML deficiencies in the bank's pouch activities and Embassy Banking unit, but no enforcement action followed. In the case of the pouch activities, as discussed earlier, despite overwhelming evidence of substantial AML deficiencies, two OCC AML examiners agonized over whether they could make the case for an enforcement action and ultimately reversed their initial recommendation for a Cease and Desist Order. In the case of the Embassy Banking unit, as discussed earlier, again despite overwhelming evidence of the bank's failure to implement effective AML controls, an OCC examiner was told point blank by his superiors, with no further explanation, that no Cease and Desist Order would be issued. The failure of OCC officials to seriously consider a formal enforcement action in either of these two extreme cases demonstrates an enforcement problem.

The OCC's AML enforcement guidance is clear in stating: "Even when the facts do not support citation of a BSA compliance program violation, the OCC may take a formal or informal enforcement action to ensure action."<sup>1878</sup> In addition, the OCC website explains:

"The OCC may take enforcement actions for violations of laws, rules or regulations, final orders or conditions imposed in writing;

<sup>1877</sup> Subcommittee briefing by OCC legal counsel (7/13/2012).

<sup>1878</sup> "Process for Taking Administrative Enforcement Actions Against Banks Based on BSA Violations," OCC 2005-45 Attachment Appendix A to OCC 2004-50, OCC-PSI-00176030.



unsafe or unsound practices; and for breach of fiduciary duty by institution-affiliated parties (IAP).”<sup>1879</sup>

These statements seem to provide the regulatory foundation and flexibility needed for the OCC to act quickly to address serious AML deficiencies, yet the HBUS case history demonstrates that the OCC remains hesitant to act, even in the face of severe AML problems and even after years of AML MRAs on record. To strengthen its AML oversight, the OCC should give strong direction to its examiners about the availability of enforcement options and create new mechanisms to require bank supervisory, enforcement, and legal personnel to review the need for formal or informal enforcement actions at banks with severe or longstanding AML deficiencies.

### (5) Issuing Weak Supervisory Letters

A final issue involves the OCC’s use of Supervisory Letters. The HBUS case history indicates these letters do not always accurately convey examination findings or the need for corrective action.

Supervision Letters are the means by which an OCC Examiner-in-Charge officially informs a bank of examination findings, apparent violations of law, and MRAs warranting management attention. Violations and MRAs require corrective action by bank management; “recommendations” do not. In theory, OCC examination findings and changes to resolve AML deficiencies should be conveyed accurately in the related OCC Supervisory Letters sent to bank management; in reality, the HBUS case history showed that some Supervisory Letters muted criticisms or weakened recommended reforms.

**PCM Examination.** One striking example of the discrepancies that arose between examination findings and Supervisory Letters involved the 2007 examination of HBUS’ Payment and Cash Management (PCM) operations. PCM specialized in global cash flow coordination, using such tools as wire transfers, cash letters, and controlled disbursement services. The volume of PCM activity at HBUS, given the bank’s size, global reach, and appetite for risk, was huge both in terms of dollars and number of transactions. In 2009, for example, PCM processed 30.2 trillion wire transfers involving \$94.5 trillion.<sup>1880</sup>

In December 2007, the OCC completed an examination of AML controls in PCM operations and found that the bank was not adequately monitoring PCM transactions.<sup>1881</sup> The OCC examination noted

<sup>1879</sup> <http://www.occ.gov/topics/laws-regulations/enforcement-actions/index-enforcement-actions.html>

<sup>1880</sup> 9/13/2010 OCC Supervisory Letter HSBC-2010-22, “Bank Secrecy Act/Anti-Money Laundering (‘BSA/AML’) Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21),” OCC-PSI-00864335. [Sealed Exhibit.]

<sup>1881</sup> 12/7/2007 OCC memorandum “BSA/AML Examination – Payment and Cash Management,” OCC-PSI-01263586.

fundamental flaws in the bank's AML controls and monitoring systems to identify suspicious activity as well as actions to clear alerts without adequately reviewing the circumstances and filing required SARs. It also recited several examples of suspicious activity and criticized the bank's Compliance Review Unit which is supposed to conduct independent testing of HBUS' AML controls but had not reviewed the PCM operations in three years. The examination findings included the following:

- "Systems and Controls are less than satisfactory and do not provide an appropriate level of monitoring for suspicious and unusual activity for all of the activities in the business unit.
- In reviewing customer activity, there were several accounts which warranted additional monitoring and/or in which monitoring practices were inadequate."<sup>1882</sup>

The examination also identified three MRAs that should be brought to the attention of HBUS' board of directors.<sup>1883</sup>

The Supervisory Letter signed by the OCC Examiner-in-Charge and sent to HBUS was issued four months later, on April 21, 2008, and conveyed a very different message about PCM operations, in part because HBUS had begun to correct the identified problems.<sup>1884</sup> The Supervisory Letter stated that the examination of PCM operations found that "the quality of risk management systems is satisfactory"; "compliance with legal and regulatory requirements is satisfactory"; and "the quality of PCM compliance risk management is satisfactory." It continued: "Policies and procedures are adequate; however, control systems needed to detect and report suspicious activity warrant improvement."<sup>1885</sup> These mild statements made in the spring of 2008, are worlds apart from the blunt examination findings issued in December 2007. Despite its language, the Supervisory Letter did include the three MRAs which, together, implied a significant breakdown in the bank's internal controls.

**Embassy Banking Examination.** A second example involved HBUS' Embassy Banking examination. As discussed earlier, in January 2008, after being contacted by two former employees, OCC conducted an examination and confirmed a wide array of troubling practices in the

<sup>1882</sup> Id.

<sup>1883</sup> The three MRAs were: "1) management needs to improve client monitoring and analysis in order to obtain an accurate view of potential risk. When an alert is generated, a more thorough review of available information needs to be initiated; 2) management must ensure that CRU [Compliance Review Unit] appropriately identifies and accurately reports on all issues, including MRAs. In addition, MRA follow-up by CRU needs to address all corrective action and include testing to determine the adequacy of actions taken; and 3) management needs to ensure that decisions related to not filing SARs are documented and maintain this information in a log." Id.

<sup>1884</sup> 4/21/2008 OCC Supervisory Letter HSBC-2007-24, "Payment and Cash Management BSA/AML Examination," OCC-PSI-00107597. [Sealed Exhibit.]

<sup>1885</sup> Id. at 1.

Embassy Banking unit. They included significant internal control problems, suspicious activity involving two high risk embassy accounts, noncompliance with bank policy, inadequate due diligence and monitoring, transactions being conducted without OFAC screening – describing, in short, some of the most egregious AML deficiencies recorded in any HBUS AML examination.<sup>1886</sup> On May 20, 2008, the OCC examiner completed a Conclusion Memorandum with the examination findings, stating that the Embassy Banking’s “AML program is not effective in identifying and mitigating risk, especially considering the nature of its clientele and the types of products and services it provides.”<sup>1887</sup> The memorandum recommended issuance of a Cease and Desist Order to ensure immediate remediation of the AML risks. The OCC examiner also discussed the recommendation for a formal enforcement action with the Examiner-in-Charge, but was informed that no Cease and Desist Order would be issued. HBUS was verbally informed of the examination findings and immediately began work to address the problems. In July, a follow-up examination looked at the bank’s remedial efforts and found that progress had been made.<sup>1888</sup>

On September 4, 2008, a Supervisory Letter summarized the March and July examinations was sent to HBUS.<sup>1889</sup> The letter’s mild tone failed to convey any of the egregious AML deficiencies or suspicious activity uncovered during the examinations, using instead bland language that conveyed minimal concern or urgency. The letter began:

- “The quality of risk management is satisfactory, but needs improvements in certain areas.
- Compliance with legal and regulatory requirements is satisfactory and no violations of law or regulation were cited at this examination.
- We noted several deficiencies in the GIB BSA/AML program that warrant the immediate remedial attention of senior management.”<sup>1890</sup>

The letter continued with a string of positive statements: “Management is competent and capable.” “The automation of existing systems and controls, together with current staff levels, will ensure a timely and

<sup>1886</sup> See also earlier discussion; 5/20/2008 OCC Memorandum, “Government and Institutional Banking,” OCC-PSI-00928614; 10/8/2008 OCC Memorandum “Royal Embassy of Saudi Arabia (RESA) March 2008 Examination Conclusions”, OCC-PSI-01434609; 4/3/2008 OCC Memorandum “Libyan Relationship Review,” OCC-PSI-01434593.

<sup>1887</sup> 5/20/2008 OCC Memorandum “Government and Institutional Banking”, OCC-PSI-00899215.

<sup>1888</sup> See 8/14/2008 OCC Conclusion Memorandum, “Government and Institutional Banking Update,” OCC-PSI-00899227.

<sup>1889</sup> 9/4/2008 OCC Supervisory Letter HSBC-2008-07, “Government and Institutional Banking BSA/AML Examination,” to HBUS, OCC-PSI-00107607. [Sealed Exhibit.]

<sup>1890</sup> Id. at OCC-PSI-00107607-608.

efficient process for monitoring accounts ....” “Currently, monitoring remains backlogged; however, management has developed a plan to bring the monitoring up to date.” “Current systems and controls are satisfactory.” “Compliance Risk is stable.”

The Supervisory Letter continued:

“Our current review has noted a marked improvement to GIB’s BSA/AML program from the second quarter of 2008 examination. Management has implemented corrective action in most of the areas of concern. The new GIB Compliance manager has implemented numerous objectives to ensure that potential risk is readily identified and mitigated to acceptable levels.

There are still some issues with system and controls, resources and alert monitoring; however, based on the current review those deficiencies are noted as MRAs.”<sup>1891</sup>

The Supervisory Letter then reduced the AML examiner’s request for a formal enforcement action against the bank to two narrow MRAs asking HBUS to: (1) “develop plans with milestones to further define and automate the risk identification and monitoring functions,” and, in the interim, “continue to enhance methods to reduce weaknesses associated with manual intervention” and prevent “unauthorized changes” to a spreadsheet with account information; and (2) cure a backlog of 1,800 alerts, some dating back to 2007, by September 15, 2008.<sup>1892</sup>

The September Supervisory Letter simply did not convey the urgency or severity of the examination findings from several months earlier regarding AML problems in the Embassy Banking department. In addition, while it presented two MRAs requiring corrective action, its mild tone and lack of detail may make bringing an enforcement action difficult if the bank fails to remedy the identified problems in a timely fashion.

**AML Staffing Problems.** A third example of discrepancies between examination findings and the Supervisory Letters that follow involved staffing issues.

In 2006, two OCC Supervisory Letters included MRAs that required HBUS to increase AML staffing in its Embassy Banking unit to monitor transactions<sup>1893</sup> and in its Compliance Review Unit to conduct internal reviews of the bank’s AML controls.<sup>1894</sup> In 2007, another Supervisory Letter again included an MRA about increasing AML

<sup>1891</sup> Id. at 609.

<sup>1892</sup> Id. at 610.

<sup>1893</sup> 1/30/2006 OCC Supervisory Letter to HBUS, OCC-PSI-00107529, at 534-35. [Sealed Exhibit.]

<sup>1894</sup> 6/14/2006 OCC Supervisory Letter HSBC-2006-16, “Compliance Review Unit Examination,” OCC-PSI-00000341. [Sealed Exhibit.]

staffing in the Embassy Banking unit.<sup>1895</sup> Two years later, in 2009, OCC AML examiners conducted examinations of HBUS' OFAC Compliance unit, Correspondent Banking, and PCM department, and identified staffing issues at all three. In February 2009, the OCC examiners wrote an internal memorandum to the file recording a disagreement with their supervisor concerning staffing. In the memorandum, the examiners identified inadequate AML staffing as "a repetitive issue that is of concern" that "should be elevated to an MRA instead of a recommendation for the Correspondent Banking (March 3, 2009 Supervisory Letter) and Payment and Cash Management examinations (March 18, 2009 Supervisory Letter)."<sup>1896</sup> The memorandum also noted that the two OCC examiners had discussed the issue with the OCC Examiner-in-Charge who disagreed with the examiners' assessment, because "there are no violations being cited and staffing is a management decision." The memorandum concludes: "Based on our growing concerns regarding Ms. Midzain's qualifications to hold the position as BSA/AML officer, her lack of concern with our recommendations and a slow deterioration of the bank's BSA/AML Program, [we] will recommend to EIC Belshaw that we complete a Compliance Management examination to assess BSA management as soon as possible."

The Examiner-in-Charge sent out three Supervisory Letters related to the examinations that had been conducted. Each reduced the requested MRA down to a recommendation that "management should consider a review of current and immediate staffing." At that point, the OCC had identified staffing problems in five business units through six exams over a period of four years, but the most recent Supervisory Letters treated the need to increase AML staffing as a recommendation rather than an MRA requiring corrective action. While it is the function of an Examiner-in-Charge to make the ultimate decision on MRAs and recommendations, this example demonstrates a clear division between the Examiner-in-Charge and her staff and a refusal to take strong action by the more senior OCC official.

In Washington, the OCC's Large Bank Review Committee, which reviewed about six draft Supervisory Letters per year for HBUS and sometimes had a copy of the underlying examinations, also noted occasional discrepancies between the examination findings and draft Supervisory Letters. In addition, some LBRC members began to notice after the fact that some examinations had revealed more significant AML problems and criticism of HBUS operations than were conveyed by the approved Supervisory Letters to HBUS management. As a result, the LBRC now requires both the AML examiner's Conclusion

<sup>1895</sup> 3/19/2007 OCC Supervisory Letter HSBC-2006-30, "Government and Institutional Banking BSA/AML Examination," OCC-PSI-00107567, at 569-570. [Sealed Exhibit.]

<sup>1896</sup> 2/5/2009 OCC Memorandum to files, "Staffing issue - Correspondent Banking," OCC-PSI-00899201.

Memorandum and the Examiner-in-Charge's draft Supervisory Letter before it will begin a review of the draft letter.<sup>1897</sup> This change should help reduce the discrepancies and ensure senior OCC officials have a more complete view of AML problems at the banks being examined.

#### **D. Analysis**

AML laws are not intended to protect bank customers or the bank; they safeguard the U.S. financial system and the nation as a whole. As the regulator of nationally chartered banks, which are among the largest, most complex, and global U.S. banks, the OCC plays a critical role in ensuring AML compliance. It is the OCC that needs to ensure the U.S. affiliates of global banks function as well-guarded gateways that keep out risk rather than invite it in.

To fulfill its AML obligations, the OCC needs to strengthen its AML oversight and revamp its AML supervisory and enforcement approach to bring them into closer alignment with other Federal bank regulators. Five reforms are key. First, it should treat AML deficiencies as a matter of safety and soundness, not consumer protection, and ensure ineffective AML management is taken into consideration when assigning a bank's CAMELS management and composite ratings. Second, the OCC should allow its examiners to cite violations of law for individual pillar violations as well as program-wide violations. Third, the OCC should ensure that narrowly focused examinations are considered in tandem with examinations that take a holistic view of a bank's AML program. Fourth, the OCC should make more use of informal enforcement actions and reconsider its standards for issuing formal enforcement actions to compel AML reforms. Finally, the OCC should instruct its Examiners-In-Charge to accurately reflect AML examination findings, without turning them into such mild recommendations that they mislead bank management into thinking their AML programs are functioning well, when they are not. Many OCC examiners see the problems; it is OCC supervisors and enforcement that need to act to strengthen the OCC's AML oversight efforts.

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<sup>1897</sup> Subcommittee interview of James Vivenzio (3/15/2012).

**Matters Requiring Attention (MRAs) and Recommendations in OCC Supervisory Letters for HSBC Bank USA, N.A.  
January 2005 - July 2009**

# of BSA Exams	Supv. Letter Date	Business Line/Area Examined	# MRAs*	# Rec.*	Internal Control Pillar Issues							Training Pillar	Independent Testing Pillar	BSA Officer Pillar	Sum of MRAs
					Bank Not Following Policies	Weak Monitoring Procedures	Weak COD/EDD Procedures	Insuff Staff Levels	Backlogs Noted	Policies Need Revision	Staff Needs Training	Testing Problems	BSA Officer Inadeq.	OFAC Issues	
1	1/26/2005	4Q04 USA Patriot Act Exam	6	0	x		x			x	x				6
2	5/20/2005	1Q05 Global Banknote Exam	6	0	x	x	x			x	x				12
3	8/9/2005	Embassy Banking Exam	0	0											12
4	1/17/2006	3Q05 Foreign Corresp. Banking Exam	7	0	x	x	x			x	x				19
5	1/23/2006	3Q05 Wire Transfer Exam	5	0	x	x	x			x	x	x			24
6	1/30/2006	4Q05 Embassy Banking Exam	4	0		x		x		x					28
7	1/31/2006	3Q05 Intr'l Private Banking Exam	7	0	x	x	x		x	x	x				35
Provisions of the 2003 Written Agreement were terminated 2/6/2006 with the above similar/systemic findings from the first seven BSA/AML exams.															
8	4/12/2006	1Q06 Domestic Private Banking Exam	3	0		x	x			x					38
9	4/27/2006	1Q06 GIB Exam	0	1				x			x				38
10	6/14/2006	1Q06 Compliance Review Unit (CRU) Exam	4	0				x		x		x			42
11	7/13/2006	1Q06 Trade Services Operations	0	3			x			x					42
12	9/26/2006	2Q06 London Global Banknote Exam	3	0	x	x	x			x	x				45
13	10/19/2006	Retail Services Compliance Exam	1	0		x									45
14	12/1/2006	Metro Exam (Credit Cards)	5	0		x	x			x					51
15	1/8/2007	Taxpayer Financial Services Compliance Exam	0	2											51
16	3/8/2007	Corporate and Institutional Banking Exam	4	1	x		x			x		x		x	55
17	3/19/2007	3Q06 GIB Exam	3	0		x		x		x					58
18	3/27/2007	3Q06 Retail Banking Exam	3	7		x	x			x					61
19	3/29/2007	4Q06 CAMP Review	1	0											62
20	5/22/2007	OCC Visit to India	0	0		x									62
21	6/17/2007	CAMP Follow-up	0	0											62
22	6/20/2007	1Q07 Corporate Trust Exam	0	0											62
23	8/6/2007	2Q07 Internal Audit and CRU Follow-up Exam	0	1								x			62
24	8/21/2007	3Q07 London Banknote Follow-up Exam	0	0											62
25	8/21/2007	3Q07 GIB Follow-up Exam	0	0											62
26	9/13/2007	Pouch Services and Middle Market Exam	5	0	x	x				x	x	x			67
27	9/21/2007	Investment Banking Exam	3	0		x	x			x					70
28	9/21/2007	Taxpayer Financial Services Follow-up Exam	1	0	x										71
29	10/15/2007	Retail Services Compliance Exam	0	1							x				71
30	2/11/2008	Card Services Compliance Exam	0	3		x				x					71
31	4/9/2008	1Q08 Audit and CRU Exam	2	1								x			73
32	4/21/2008	4Q07 PCM Exam	3	0		x				x	x	x			76
33	6/2/2008	Singapore/Hong Kong Banknotes Exam	0	2											76
34	7/10/2008	Taxpayer Financial Services Compliance Exam	1	0											77
35	9/4/2008	2Q08 and 3Q08 GIB Exam	2	0	x	x	x	x	x	x					79
36	1/20/2009	4Q08 OFAC Exam	0	1				x							79
37	1/22/2009	3Q08 Pouch Follow-up Exam	0	0											79
38	3/3/2009	4Q08 Correspondent Banking Exam	0	2				x							79
39	3/18/2009	4Q08 Private Banking Exam	2	1		x				x					81
40	3/18/2009	4Q08 PCM Exam	0	1				x							81
41	5/27/2009	Taxpayer Financial Services Compliance Exam	0	0											81
42	6/24/2009	2Q09 GIB Follow-up Exam	1	3		x				x	x	x			82
43	7/7/2009	Compliance Management Exam	1	0								x			83
<b>TOTALS</b>			<b>83</b>	<b>30</b>	<b>10</b>	<b>19</b>	<b>13</b>	<b>8</b>	<b>2</b>	<b>21</b>	<b>11</b>	<b>9</b>	<b>1</b>	<b>1</b>	

Prepared by the U.S. Senate Permanent Subcommittee on Investigations, July 2012.

**Permanent Subcommittee on Investigations  
EXHIBIT #1a**

## **HBMX Compliance Failures**

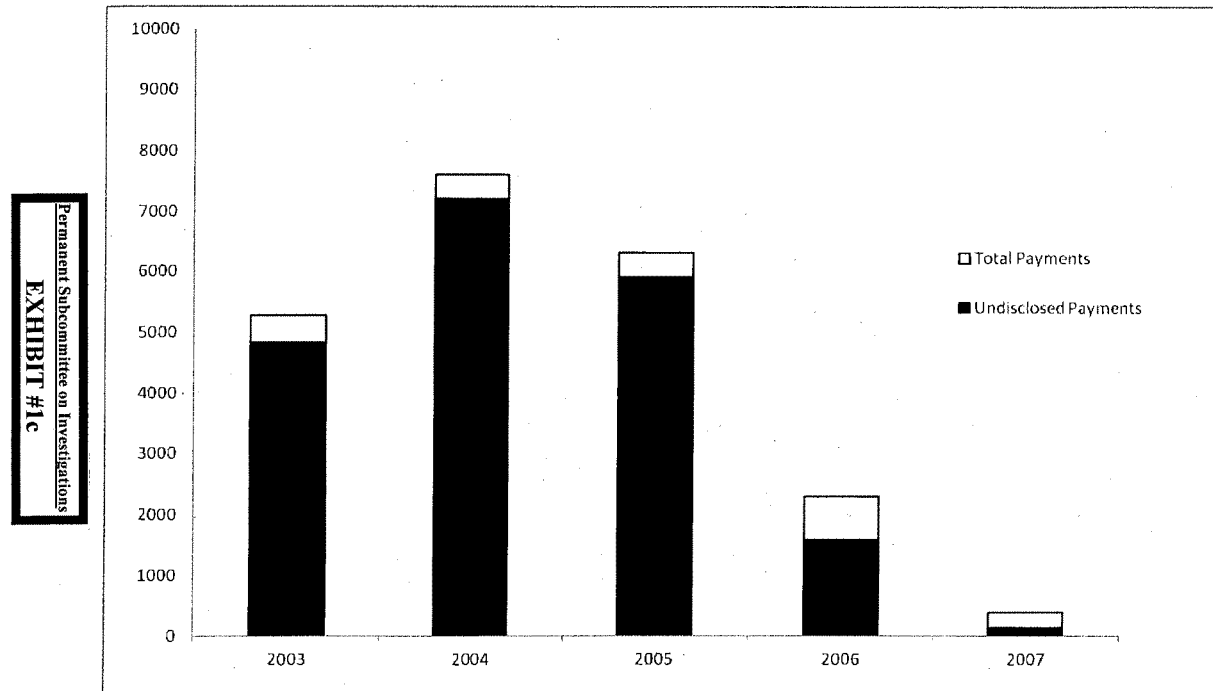
- 2002** “There is no recognisable compliance or money laundering function”
- 2005** “Fabricated records of certain mandatory anti-money laundering meetings”
- 2007** “What is this, the School of Low Expectations Banking?”
- 2008** “There were allegations of 60% to 70% of laundered proceeds in Mexico [going] through HBMX”
- 2008** “What I find most frustrating is the way in which new issues constantly emerge however much time is spent with HBMX.”
- 2009** “[I]nherent AML risk in Mexico is still very high”

Prepared by the U.S. Senate Permanent Subcommittee on Investigations, July 2012

Permanent Subcommittee on Investigations
<b>EXHIBIT #1b</b>



### Disclosed v. Undisclosed Iranian U.S. Dollar Payments Sent by HSBC Foreign Affiliates to U.S. Banks, Including HSBC Bank USA



Original Source: Deloitte March 29, 2012 presentation, HSBC OCC 8966143.  
Prepared by U.S. Senate Permanent Subcommittee on Investigations, July 2012

**Excerpts from emails of David Bagley**  
**re HBUS awareness of Iranian transactions, 2003-2004**

“I am not sure that HBUS are aware of the fact that HBEU are already providing clearing facilities for four Iranian banks, presumably including USD clearance.”

--HSBC email, 10/21/2003, Exhibit 46, HSBC OCC 88733947

“The complexity of the OFAC regulations, and the fact that HBUS were unaware that any arrangements existed with Iranian Banks, has made speedy resolution of this issue difficult.”

--HSBC email, 03/11/2004, Exhibit 52, HSBC OCC 8873986

“I suspect that HBUS are not aware that payments may be passing through them. Do not believe that we can allow this situation to continue very much longer...”

--HSBC email, 04/19/2004, Exhibit 53, HSBC OCC 8873994

Permanent Subcommittee on Investigations

**EXHIBIT #1d**

Permanent Subcommittee on Investigations  
**EXHIBIT #1e**

## **RATINGS USED IN OCC REPORT OF EXAMINATIONS**

### **Composite Uniform Financial Institution Rating**

#### **Component Ratings:**

Capital

Asset Quality

Management

Earnings

Liquidity – Asset/Liability Management

Sensitivity to Market Risk

579

**Uniform Rating System for Information Technology**

**Composite Uniform Interagency Trust Rating**

**Uniform Interagency Consumer Compliance Rating**

**Community Reinvestment Act Rating**

### **31 USC § 5318 (h)**

“(h) ANTI-MONEY LAUNDERING PROGRAMS.—

“(1) IN GENERAL.—In order to guard against money laundering through financial institutions, each financial institution shall establish anti-money laundering programs, including, at a minimum—

- “(A) the development of internal policies, procedures, and controls;
- “(B) the designation of a compliance officer;
- “(C) an ongoing employee training program; and
- “(D) an independent audit function to test programs.”

Home > News>HSBC to testify at U.S. Senate hearing

## HSBC to testify at U.S. Senate hearing

10 Jul 2012

Group news

*In this letter to all employees, Group Chief Executive Stuart Gulliver explains why we have been asked to testify about past compliance failures and what we have done since to strengthen compliance and risk management.*

Dear Colleague,

I am writing to you today as you may have seen reports that HSBC has been asked to testify before the U.S. Senate's Permanent Subcommittee on Investigations (PSI) on Tuesday 17 July.

The hearing relates to ongoing investigations by the PSI into our compliance with U.S. regulations including Anti-Money Laundering laws, the Bank Secrecy Act and the Office of Foreign Assets Control sanctions.

While we have previously disclosed these proceedings in our Annual Report and Accounts, the PSI hearing will be the first time that the details of these investigations are made public. It will certainly be the first time that the majority of employees have heard about these issues and I realise it will be a disappointment to you and your teams.

While we have been cooperating with the relevant U.S. authorities since 2010 to improve the way we manage risk and ensure compliance, the PSI hearing may attract significant attention. It is also likely that there will be further enforcement actions from other U.S. authorities over the coming months.

I wanted to ensure that you and your teams had enough information about these issues to be able to answer the questions that you may be asked by your customers, colleagues, friends and family.

While we do not yet know the full details of the PSI investigation, the hearing on 17 July will undoubtedly reveal that in the past we fell well short of the standards that our regulators, customers and investors expect.

During the hearing, we will acknowledge and apologise for our past mistakes. Between 2004 and 2010, our anti-money laundering controls should have been stronger and more effective, and we failed to spot and deal with unacceptable behaviour.

It is right that we be held accountable and that we take responsibility for fixing what went wrong. As well as answering the subcommittee's questions, we will explain the significant changes we have already made to strengthen our compliance and risk management infrastructure and culture.

First, with a new strategy and leadership team, we have put in place a structure that makes HSBC easier to manage. The creation of four global businesses and ten global functions to replace a federated structure allows a coordinated and consistent approach to every part of our business, including compliance.

Second, we have decided to apply high and consistent global standards wherever we work. The Group Standards Committee co-chaired by Group Chief Legal Officer Stuart Levey and Group Chief Risk Officer Marc Moses is working towards ensuring that the highest standards required in any part of the business will apply to every part of the business.

Third, we are driving a change in culture so that our conduct matches our values. We have integrated our values into performance management, judging senior leaders on what they achieve and how they achieve it, because both matter to our reputation and share price.

Permanent Subcommittee on Investigations

**EXHIBIT #2a**

PSI-HSBC-76-0001

Alongside these changes, we will continue to invest in a best-in-class compliance function. We have increased the amount spent on compliance globally from US\$200m in 2010 to US\$400m today. Some 3,500 colleagues now work in HSBC compliance worldwide, with more than 1,000 of them in the U.S.

There is no doubt that the coming weeks and months will be challenging, as past practices and compliance failures in certain parts of the firm come under serious scrutiny from regulators, investors, media, customers and employees. I know this will be a disappointment to the vast majority of you who have worked so hard to build and maintain our reputation throughout the turbulence of the past few years, and for that I apologise. I can also assure you that we will also keep you fully informed of these matters via the global staff website and other internal channels.

While we cannot undo past mistakes, we will be judged on how we respond to this issue and demonstrate that we have learnt from it. You have my commitment that we will face up to our past mistakes, show our stakeholders what we have done to address the problems, and never let up in our absolute commitment to ensuring that every part of the firm meets the highest global standards and lives up to our values in the future. As the illicit actors seeking to exploit the financial system are constantly adapting their approach, we will need to be tireless in our own efforts to stop them.

We will do this not just because regulators and authorities expect it of us, but more importantly, because we expect and demand it of ourselves.

This is a fundamental part of achieving our strategy and becoming the world's leading international bank and remains a top priority for the Board and senior management team.

**Stuart Gulliver**  
Group Chief Executive

## Contact Global Communications

**Pierre Goad** Charles Naylor Global Co-Heads of Communications

**Larry Campbell** Head of Publishing and Knowledge Management

**Jezz Farr** Global Head of Communications, Global Banking and Markets

**Medard Schoenmaeckers** Global Head of Communications, Global Private Banking

**Tim Harrison** Global Head of Communications, Commercial Banking

**Malcolm Wallis** Global Head of Communications, Retail Banking and Wealth Management

**Susanna Wilson** Head of Communications, Corporate Sustainability

**Phil Askham** Global Head of Global Functions Communications

**Margrit Chang** Regional Head of Media Relations, Asia Pacific

**Andy Berry** Regional Head of Media Relations, UK and Europe

**Jo Alexander** Regional Head of Employee Communications, UK and Europe; Head of Group COO Communications

**Enrique de la Madrid** Regional Head of Communications, Latin America and Mexico

**Lisa Sodeika** Regional Head of Communications, North America

**Tim Doyne** Regional Head of Communications, Middle East and North Africa

PSI-HSBC-76-0002

## GCL 120014 - HSBC Global Standards

### Background

A year ago, we articulated a clear strategy to be the world's leading international bank. In order to make the firm more cohesive and better connected, we established Global Businesses and Global Functions and gave them the authority to manage the firm on a global basis with consistent policies, standards and processes. We also articulated a set of HSBC values to guide our behaviour.

Our ability to achieve our ambition ultimately depends on our reputation, not just for financial strength, but also for trustworthiness and integrity. Too often, we have fallen short of our own expectations and that must change. We now have the structure to help us reduce complexity and run the firm more effectively on a global basis, but structure is not enough. To preserve and enhance our reputation, we must also lead our industry in formulating and implementing global standards and controls to ensure that our conduct matches our values.

### What does this mean in practice?

Amongst other things, this means we must:

- adopt and enforce the adherence to a single standard globally that is determined by the highest standard we must apply anywhere. Often, this will mean adhering globally to US regulatory standards, but to the extent another jurisdiction requires higher standards, then that jurisdiction's requirements must shape our global standard
- maximise the sharing of information for risk management purposes amongst Group companies and amongst Global Businesses and Functions
- apply a globally consistent approach to knowing and retaining our customers. When we conclude that any customer or potential customer poses an unacceptable reputational risk (or otherwise does not meet our standards), we should exit or avoid the relationship globally
- ensure that our banking services are not used to facilitate tax evasion anywhere or to hide the proceeds of corruption or crime
- maintain ethical sales practices

Setting and implementing standards and controls is not solely the job of our control functions such as Risk, Legal, Finance and Internal Audit. All of us – across all businesses, all geographies, and all levels of the firm – have a personal responsibility to make this happen. While the Group is made up of many legal entities around the world, we have only one reputation and we are all guardians of it.

### Steering Committee on HSBC Global Standards

This will be an ongoing and continuous effort, impacting all of our businesses all over the world. As you all know, much of this work is already well underway. To facilitate comprehensive oversight of these matters, identify additional areas requiring attention, and to determine best practices, I have asked the Group Chief Risk Officer Marc Moses, and Chief Legal Officer Stuart Levey to co-chair a Steering Committee on HSBC Global Standards. This Committee will operate under the supervision of the Group Risk Management Meeting to define the HSBC Global Standards and to ensure that those Global Standards are implemented.

Yours faithfully,

Stuart Gulliver  
Group Chief Executive

PSI-HSBC-75-0001

Permanent Subcommittee on Investigations  
EXHIBIT #2b

Global Businesses	Global Functions	Countries	Tools
Home > Group Corporate Offices > GCL 120014			
<h2>GCL 120014 - HSBC Global Standards</h2> <p><b>Background</b></p> <p>A year ago, we announced a clear strategy to be the world's leading international bank, in order to make the bank more cohesive and better managed, we established Global Businesses and Global Functions and gave them the authority to manage the bank on a global basis with consistent policies, standards and processes. We also articulated a set of HSBC values to guide our behaviour.</p> <p>Our ability to achieve our ambition ultimately depends on our reputation, not just for financial strength, but also for trustworthiness and integrity. To protect, we have fallen short of our own expectations and that must change. We now have the structure to help us reduce complexity and run the bank more effectively on a global basis, but structure is not enough. To preserve and enhance our reputation, we must also lead our industry in formulating and implementing global standards and controls to ensure that our conduct matches our values.</p> <p><b>What does this mean in practice?</b></p> <p>Amongst other things, this means we must:</p> <ul style="list-style-type: none"> <li>• align and enforce the adherence to a single standard globally that is determined by the highest standard we must apply anywhere. Often, this will mean adhering globally to US regulatory standards, but to the extent another jurisdiction requires higher standards, then that jurisdiction's requirements must shape our global standard</li> <li>• maximise the sharing of information for risk management purposes amongst Group companies and strengthen Global Businesses and Functions</li> <li>• apply a globally consistent approach to knowing and retaining our customers. When we conclude that any customer or potential customer poses an unacceptable reputational risk for otherwise does not meet our standards, we should end or avoid the relationship globally</li> <li>• ensure that our banking services are not used to facilitate tax evasion anywhere or to hide the proceeds of corruption or crime</li> <li>• maintain ethical sales practices</li> </ul> <p>Forming and implementing standards and controls is not solely the job of our control functions such as Risk, Legal, Finance and Internal Audit. All of us - across all businesses, all geographies and all levels of the firm - have a personal responsibility to make this happen. While the Group is made up of many legal entities around the world, we have only one reputation and we are all part of it.</p> <p><b>Steering Committee on HSBC Global Standards</b></p> <p>This will be an ongoing and continuous effort, impacting all of our businesses all over the world. As you all know, much of this work is already underway. To facilitate comprehensive oversight of these matters, I have established a steering committee and to determine best practices. I have asked the Group Chief Risk Officer Marc Mouys, and Chief Legal Officer Stuart Levey to co-chair a Steering Committee on HSBC Global Standards. This Committee will operate under the supervision of the Group Risk Management Meeting to define the HSBC Global Standards and to ensure that these Global Standards are implemented.</p> <p>Yours faithfully,</p> <p><b>Stuart Gulliver</b> Group Chief Executive</p>			
<h3>Contact Global Communications</h3> <p><b>Bob Scott</b> Charles Naylor Global Co-Heads of Communications</p> <p><b>Larry Campbell</b> Head of Publishing and Knowledge Management</p> <p><b>John Farr</b> Global Head of Communications, Global Banking and Markets and Global Private Banking</p> <p><b>Malcolm Wicks</b> Global Head of Communications, Retail Banking and Wealth Management</p> <p><b>Lady Harding</b> Regional Head of Communications, Middle East and North Africa</p> <p><b>Suzanne Wilson</b> Head of Communications, Corporate Sustainability</p> <p><b>Don Agnew</b> Global Head of Global Functions Communications</p> <p><b>Emily Tenny</b> Regional Head of Communications, Asia Pacific</p> <p><b>Ruth Neillson</b> Regional Head of Employee Communications, Asia Pacific</p> <p><b>Margrit Chang</b> Regional Head of Media Relations, Asia Pacific</p> <p><b>Jo Alexander</b> Regional Head of Employee Communications, UK and Europe, Head of Group COO Communications</p> <p><b>Emilio de la Madrid</b> Regional Head of Communications, Latin America and Mexico</p> <p><b>Tom Harrison</b> Global Head of Communications, Commercial Banking</p> <p><b>Lisa Boehme</b> Regional Head of Communications, North America</p>			

### Global links

#### Group manuals system

Annual IFR  
About the business  
Commercial Banking IFR  
Global Markets IFR  
Financial Services IFR  
Private IFR  
Treasury IFR

#### Security travel advice

Security when traveling abroad  
Getting help on emergency  
Information on  
Legal issues  
Alerts and updates

#### My Solution Centre

HSBC's new mobile app  
Global Banking Solutions  
HSBC Banking tools  
GSM  
HSBC customer tools

#### About HSBC

What's new  
A brief overview  
Group strategy  
Our people  
Our growth  
Our history  
Our values

PSI-HSBC-75-0001

<http://home.global.hsbc/gc/home.nsf/ByRef/UKCM8TUT6217092130042012?OpenDocu...> 04/30/2012



Home > Group Standards Manual > Chapter 5 Legal, Compliance and Reputation

### Chapter 5 Legal, Compliance and Reputation

<http://fim.ghq.hsbc/FIM/home.nsf/ByRef/UKWE78JFKP11334701112007?Open> Printed Monday, 16 July, 2012

## Chapter 5 Legal, Compliance and Reputation

### Legal

The Global Legal Function is responsible for providing and managing legal services to members of the HSBC Group, thereby facilitating its business and for protecting the Group from legal risk as well as its integrity and reputation. The Group General Counsel maintains a close relationship with the Chief Risk Officer (CRO).

The Global Legal Function operates through individual legal departments in more than 50 countries. Regional General Counsel for North America; Latin America; Europe; Middle East; Asia Pacific; the Global Head of Global Banking and Markets, Legal; the Head of GBL LGA and the Chief Operating Officer, GBL LGA together with the Group General Counsel form the Group Legal Executive Committee. The Group Legal Executive Committee has primary responsibility for providing leadership and guidance across the function, while the responsibility for providing legal support to the business rests with the individual country departments.

Legal risk is a combination of a variety of risks. In particular:

**Contractual Risk** is the risk that the rights and/or obligations of a Group member within a contractual relationship are defective;

**Dispute Risk** is made up of the risks that a Group member is subject to when it is involved in or managing a potential dispute or actual dispute;

**Legislative Risk** which is the risk that a Group member fails to adhere to the laws of the jurisdictions in which it operates; and

**Non-Contractual Rights Risk** which is the risk that a Group member's assets are not properly owned or are infringed by others or the infringement by a Group member of another party's rights.

For additional detail on legal risk and HSBC's policies to control such risk, please refer to the Legal and Compliance FIM.

### Compliance

The structure of the Group's Compliance function is designed to fit closely with the structure of the business and is divided according to geographic units (each country or jurisdiction is headed by an Area Compliance Officer who functionally reports to the relevant Regional Compliance Officer) and Global Businesses (which are typically subject to oversight by a Global Business Compliance Officer). Furthermore for major Group companies, typically those with a dedicated audit committee, a Global Head of Compliance will exist to co-ordinate Local Compliance Officers both within that company's domestic and overseas offices.

Group Compliance in Group Headquarters is the centre of the Compliance function, setting Group-wide policy and supporting the regional/product networks as well as advising Group executives on all regulatory matters. The Head of Group Compliance reports to the Chief Risk Officer, but also has close association with the Group General Counsel so a holistic view of risk across the Group's functions can be obtained.

Given the geographical spread of the Group and the number of financial markets in which it operates, the breadth and depth of legislation and regulation to which the Group is subject is enormous. The penalties for contravening rules and regulations are also increasing in severity. Compliance risk is closely bound with reputational risk and the perception of the Group by customers and others can be readily damaged by

Permanent Subcommittee on Investigations

EXHIBIT #2c

<http://fim.ghq.hsbc/FIM/home.nsf/ByRef/UKWE78JFKP11334701112007?Open&Print...>

07/15/2012

a failure to comply with relevant laws. Any wilful or negligent contravention by a Group operation will be regarded very seriously.

For full details of the globally-applicable Compliance policies in place to safeguard the HSBC Group against regulatory risk, refer to the Compliance section of the Legal and Compliance FIM. In some cases, such policies will be supplemented at Global Business level by the appropriate business FIM.

The following Compliance Policy Statement was adopted by the Board of HSBC Holdings plc on 12MAR93 and is required to be adopted formally by all major operating subsidiaries within the Group:

"It is the policy of the HSBC Group (the Group) to observe high standards of integrity and fair dealing in the conduct of its business and to act with due skill, care and diligence.

To those ends, Group members should:

- comply with both the letter and spirit of all relevant laws, codes, rules, regulations and standards of good market practice in each jurisdiction around the world where they conduct business; and
- ensure that any irregularities which arise are promptly resolved in a manner which minimises financial loss and protects the good name and reputation of the Group."

Management at all levels must ensure they, or their executives with delegated managerial responsibilities, are fully acquainted with the rules and regulations applying to the operations for which they have responsibility and that arrangements for ensuring compliance with legal/regulatory requirements are an integral part of the operational procedures of the business. Where managers become aware of breaches of laws or regulations, they must advise their Local Compliance Officer.

Published: 27/Feb/2012

#### INTERNAL

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<http://fim.ghq.hsbc/FIM/home.nsf/ByRef/UKWE78JFKP11334701112007?Open&Print...> 07/15/2012

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OCC-PSI-0089823

HSaC-OCC\_E 0056298.txt  
 From: DAVID DEW/HBUS/HSBC  
 Sent: 9/4/2008 4:22:57 PM  
 To: LESLEY MIDZAIN/HBUS/HSBC@HSBC02  
 CC:  
 Subject: Re: Fw: Kyc hires

Lesley

I am out next week but would a couple of temps for two months do the trick?

David

David Dew  
 SEVP, Chief Operating Officer  
 HSBC Bank USA  
 452 Fifth Avenue | 10th Floor | New York, NY 10018

Phone: 212-525-6951  
 Fax: 212-525-8688  
 Email: david.dew@us.hsbc.com

Lesley Midzain/HBUS/HSBC  
 09/04/2008 03:57 PM

To: David Dew/HBUS/HSBC@HSBC02  
 cc: Andrew P LONG/IBEU/HSBC@HSBC, Chris P DAVIES/HBUS/HSBC@HSBC02, Michael B Gallagher/HBUS/HSBC@HSBC02  
 Subject: Re: Fw: Kyc hires

David,

I think we are keeping our view and our plans firmly focused on the future, but are still grappling with some of the grim realities of the present - the upcoming OCC exam in November being one of those grim realities. But I am happy to explore other suggestions for providing 'quick fixes' for the situation, whether those are business-related or compliance-related, and think a meeting is a very good idea (early next week perhaps?). I will also pull together the additional Compliance information you've requested and forward.

Lesley

Lesley Midzain  
 EVP & Chief Compliance Officer | HSBC BANK USA, N.A.  
 452 5th Ave. 7th Fl.  
 New York, NY 10018

Phone: 212-525-6410  
 Fax: 212-525-5769  
 Mobile: [REDACTED]

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 Subcommittee on Investigations

Page 1

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Permanent Subcommittee on Investigations  
 EXHIBIT #3

, Inc. HSB02545486

Confidential - FOIA Treatment Request

N.A. HSBC OCC 0616352

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OCC-PSI-0089824

HSBC-OCC\_E 0056298.txt  
 Email Lesley.Midzain@us.hsbc.com

David Dew/HBUS/HSBC  
 09/04/2008 12:23 PM

To Lesley Midzain/HBUS/HSBC@HSBC02  
 CC Andrew P LONG/TREU/HSBC@HSBC, Chris P DAVIES/HBUS/HSBC@HSBC02, Michael B  
 Gallagher/HBUS/HSBC@HSBC02  
 Subject  
 Re: FW: Kyc hires

Thanks Lesley.

I do think that collectively we need to step back and consider the full financial impact of what we are proposing for our PCM business at a time when the business is being asked to consider carefully its strategic objectives, both from a customer perspective and also from a OneHSBC perspective.

The proposal on the table is to add a total of 8 fte to support compliance related activity. I appreciate that they are not all additional positions from a budget standpoint but nevertheless there will be a significant impact on total operating expenses at a time when we are also tasked with keeping costs flat to 2008.

Therefore, I would still like my earlier questions answered but with the analysis amended to account for the additional compliance staff in your area which are of course charged back to the business. One further example of where we would benefit from additional clarity: you correctly say that the Cash Letter process is very paper intensive so the function cannot move offshore. What is the profitability of this business and what automation plans do we have because perhaps we should be considering eliminating some of the manual activity?

I think that we must also use this opportunity to accelerate the HNAH centralization initiative. As you say, the request by PCM is effectively to add resource to an operational team. We should be looking to put such resource into a central utility at every opportunity as is envisaged in the ICRM report. If you can do the same with the routine compliance monitoring activity, then economies of scale should result.

I appreciate that this is not the response that you are collectively looking for but in the current environment I feel we must at least ask some harder questions and not simply approve additional headcount. Equally, I am mindful that we have an alert backlog in the PCM business and I should be grateful for an update as to where we stand with this.

Happy to get together if a meeting will help.

Regards

David

David Dew

Page 2

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Confidential &amp; Non-public OCC Information

OCC-PSI-0089824

SEVP, Chief Operating Officer  
 HSBC Bank USA  
 452 Fifth Avenue | 10th Floor | New York, NY 10018

Phone. 212-525-6951  
 Fax. 212-525-8688  
 Email. david.dew@us.hsbc.com

Lesley Midzain/HBUS/HSBC  
 09/03/2008 03:09 PM

To  
 David Dew  
 CC  
 Chris P DAVIES/HBUS/HSBC@HSBC02, Andrew P LONG/IBEU/HSBC@HSBC, Charles G  
 DelBusto/HBUS/HSBC@HSBC02, "Ian MACALESTER" <ian.macalester@hsbc.com>, Michael  
 B Gallagher/HBUS/HSBC@HSBC02, Denise A Reilly, alan p williamson  
 Subject  
 Rvt: Kyc hires

David,

We would support the request. PCM has an operational team that does client on-boarding and file review in Delaware and we understand they have had some outstanding vacancies. The team was created in response to an OCC comment several years ago and focused on high risk customers and financial institutions. The team was successful and PCM extended their remit to additional customer types in response to an audit comment and to ensure consistency across the business unit. Consistent with the bank's strategic direction, the team looks to Compliance for advice and guidance but do the actual file reviews and document collection themselves.

These activities are independent of Compliance advisory and monitoring work and resources. On the latter point, we had been in process of trying to hire for 3 additional approved positions (per your approval from late JUN), 2 for targeted monitoring and one more senior LCO. In recent weeks, a couple of events happened that affected our progress:  
 - the freeze for hiring in global businesses was put into effect. We were advised that this applied in the PCM world, and so we suspended our hiring efforts;  
 - two members of the compliance staff in Delaware resigned (one to take a position with the business).

As a result we reviewed our staffing proposal and concluded that we would use this as an opportunity to reduce the 5 vacant compliance positions (3 as approved + 2 recent departures) to 4, all outside of New York. Attached is the one-pager we had just prepared which explains and supports that analysis. Given the hiring freeze in global businesses, I understand that it may also need approval by Paul Lawrence, but this has continued to be an area of notable risk and regulatory attention and which needs some stabilization for compliance resources. In making the proposal, we continue to seek the most efficient and cost-effective means of providing some needed support. My staff has consulted with Michael in this process and understands that he is supportive.

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OCC-PSI-0089824

HSBC-OCC\_E 0056298.txt  
 [attachment "PCM Opens - Summary Request 3SEP08.doc" deleted by Lesley Midzain/HBUS/HSBC]

Lesley

Lesley Midzain  
 EVP & Chief Compliance Officer | HSBC BANK USA, N.A.  
 452 5th Ave. 7th Fl.  
 New York, NY 10018

Redacted by the Permanent  
 Subcommittee on Investigations

Phone 212-525-6410  
 Fax 212-525-5769  
 Mobile [REDACTED]  
 Email Lesley.Midzain@us.hsbc.com

----- Forwarded by Lesley Midzain/HBUS/HSBC on 09/03/2008 02:41 PM -----

David Dew/HBUS/HSBC  
 09/03/2008 10:11 AM

To Chris P DAVIES/HBUS/HSBC@HSBC02  
 CC Andrew P LONG/IBEU/HSBC@HSBC, Charles G DelBusto/HBUS/HSBC@HSBC02, "Ian MACALESTER" <ian.macaulester@hsbc.com>, Michael B Gallagher/HBUS/HSBC@HSBC02, Lesley Midzain/HBUS/HSBC@HSBC02  
 Subject Re: Kyc hires

Chris

As we all know, PCM is a high risk business from a BSA/AML perspective and we need to ensure that we have sufficient qualified resource to meet regulatory requirements. As such, I have asked Compliance for their views on this request.

That said, I will need more detailed information. A proposed increase of 4 FTE is significant. What precisely is driving this increase? What is the volume growth of the business in terms of number of customers and who are these customers from a risk profile perspective? Do they fit in with our overall strategy? What is the underlying profitability of this projected growth?

What is the current number of Compliance FTE in the business and how are they deployed? What exactly will the additional 4 people be doing? What progress are we making in terms of further offshoring and utilizing the Global Centres of Excellence? What scope do we have for further cost reductions in other areas, eg payments operations following the centralization under Tom Kaiser?

Finally, I note Michael's comments concerning cost saves but will the business be able to meet the overall corporate goal of keeping 2H expenses flat to 1H?

Thanks

David

David Dew  
 SEVP, Chief Operating Officer  
 HSBC Bank USA

Page 4

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Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 0616355

Confidential &amp; Non-public OCC Information

OCC-PSI-0089824

HSBC-OCC\_E 0056298.txt  
 452 Fifth Avenue | 10th Floor | New York, NY 10018

Phone. 212-525-6951  
 Fax. 212-525-8688  
 Email. david.dew@us.hsbc.com

Chris P DAVIES/HBUS/HSBC  
 09/03/2008 08:49 AM

To: Michael B Gallagher/HBUS/HSBC@HSBC02  
 cc: Andrew P LONG/IBEU/HSBC@HSBC, David Dew/HBUS/HSBC@HSBC02, Charles G DelBusto/HBUS/HSBC@HSBC02, "Ian MACALESTER" <ian.maclester@hsbc.com>  
 Subject: Re: Kyc hires

I ask for davids guidance with respect to compliance resource.

As regards adds within pcm, as previously discussed, operational integrity is clearly a high priority, however fte adds in this climate will need to be offset by reductions elsewhere in your business in order for a flat cost profile to be achieved.

I know we will be discussing this point at 9 30.

Thanks

----- Original Message -----

From: Michael B Gallagher  
 Sent: 09/03/2008 08:08 AM EDT  
 To: Chris P DAVIES  
 Cc: Andrew P LONG; David Dew; Charles DelBusto  
 Subject: Kyc hires

Chris,

As you are aware, I have expressed considerable concern for some time over the lack of resources both in compliance and within pcm to adequately support kyc and related regulatory requirements.

I can not speak to what compliance is doing to add further support to their team, however I wish to ensure that pcm does what it needs to. To this end we have requested 4 adds to staff with immediate effect.

The occ will be here in q4 and we must ensure that resources are sufficient to give comfort to the occ that we take this seriously.

I would appreciate guidance on how/when we can remedy the situation.

Mbg

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**30 Day Observations and Recommendations Report from AML Director**

To: Curt Cunningham  
 From: Wyn Clark  
 Date: Thursday, October 15, 2009

**Profile of HSBC**

Extremely high risk business model from AML perspective:

Risk:	High
Compliance:	
Reputation:	
Regulatory:	
Financial:	
AML:	
	Products/Services
	Transactions
	Client
	Geographic

**Current Observations**

AML Director has the responsibility for AML compliance, but very little control over its success

Operate under "crisis" mode, actions are reactive rather than forward thinking

AML Director unable to manage at high level

Several AML Directors/BSA Officers in a short period of time

Systems and controls not adequate for risk profile of organization:

- OFAC misses and backlog
- Large # of MRAs
- Training
- Barton Adams
- Threat of repeat MRA in GIB

Where are concerns with control environment?

- Reporting lines
- Business and AML Expertise
- Technology
- Head count

Permanent Subcommittee on Investigations  
**EXHIBIT #4**

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HSBC-PSI-PROD-0065332



Independence  
MIS

Appear to have lost urgency of AML compliance since previous enforcement action was lifted

AML risk profile of HBIO vs. HBUS are extreme opposites

Decentralized functions creates inefficiencies, inconsistencies and a greater potential of things falling through the cracks or missed all together

Commingleing of general compliance with that of AML

Not clear on why AML Director is in COE

**Proposed Organization (CTP)**

AML Director has responsibility for AML compliance as delegated by the BoDs (HBUS, NA BOD and North America BOD) but very little control, oversight or direct authority over its success.

**Proposals**

AML Compliance should have its own channel within HNAH compliance

Groups supporting AML to have direct reporting into AML Director (see draft org. chart)

To ensure that AML Compliance is maintained throughout the entire North America region it is critical that there is a lead/head in the following key areas. These heads should report directly to the AML Director or advisors in the AML Director's office that oversee these key areas for all of HNAH:

Policy/Dep Director  
FIU  
    Surveillance/Monitoring  
    Investigations  
    SAR Reporting  
Sanctions  
KYC/CDD/EDD  
Training  
Regulatory Exam/Internal Audit  
MIS/Metrics

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HSBC-PSI-PROD-0065333

Reporting-Non SAR

Represented in AML Governance Council:  
Business Line AML Officers/Heads  
LCOs w/ AML component

**Questions**

Is there a budget for AML?

**Priorities**

- 1) FIU report to AML Office
- 2) Report AML risks and issues to BoD
- 3) Structure and staffing of AML Office
  - a. Oversight, SME, Policy,
  - b. Operations – FIU primarily
- 4) Fix OFAC – drill down to determine ultimate root cause and fix, then fix other issues
- 5) Norkom implemented in GIB
- 6) Full scope assessment of AML risk vs. control and system environment
- 7) AML/OFAC risk assessment process
- 8)

Confidential Treatment Requested

HSBC-PSI-PROD-0065334

595

Occ-Psi-00162661

From: DEBRA L BONOSCONI/HBUS/HSBC  
Sent: 10/19/2009 5:21:45 PM  
To: WYNDHAM S CLARK/HBUS/HSBC@HSBC02  
Subject: Re: Fw: OFAC resources

Oh, this was express time. Trust me on that. Usually the response is "no."

----- Original Message -----  
From: Wyndham S Clark  
Sent: 10/19/2009 05:19 PM CDT  
To: Debra L Bonosconi  
Subject: Re: Fw: OFAC resources  
Clearly a positive, although I understand these were requested quite a while ago. I hope that isn't the typical response time.

----- Original Message -----  
From: Debra L Bonosconi  
Sent: 10/19/2009 05:49 PM EDT  
To: Wyndham S Clark  
Subject: Re: Fw: OFAC resources  
Well, not really. Yes good that we got new positooons but not good in that we don't get the staffing levels we need.

----- Original Message -----  
From: Wyndham S Clark  
Sent: 10/19/2009 04:26 PM EDT  
To: Debra L Bonosconi  
Subject: Re: Fw: OFAC resources  
Good.

Wyn Clark  
Anti-Money Laundering Director | HSBC - North America  
452 Fifth Avenue, 7th Floor, New York, NY 10018

---

Phone. 212-525-8025  
Fax. 212-642-1543  
Email. wyndham.s.clark@us.hsbc.com

---

Debra L Bonosconi/HBUS/HSBC  
10/19/2009 02:33 PM

To  
"wyndham s clark" <wyndham.s.clark@us.hsbc.com>  
cc  
  
Subject  
Fw: OFAC resources

Fyi

Page 1

Permanent Subcommittee on Investigations <b>EXHIBIT #5</b>
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Occ-Psi-00162661

----- Original Message -----

From: Lesley Midzain  
Sent: 10/19/2009 02:23 PM EDT  
To: Alisha Marshall; Debra L Bonosconi  
Cc: Curt Cunningham  
Subject: OFAC resources

Janet has approved the 3 resources (2 transaction monitoring, 1 analyst).  
She has to take this to Paul Lawrence, but we can start the search for the 3 in  
order not to lose time.

Lesley

Lesley Midzain  
Executive Vice President & Chief Compliance Officer | HSBC Bank USA  
452 Fifth Ave, New York, NY - 7th Fl.

---

Phone. 212-525-6410  
Fax. 212-525-5769  
Mobile. [REDACTED]  
Email. Lesley.Midzain@us.hsbc.com

---

— = Redacted by the Permanent  
Subcommittee on Investigations

Occ-Psi-00165898

From: WYNDHAM S CLARK/HBUS/HSBC  
 Sent: 2/26/2010 12:02:08 PM  
 To: DEBRA L BONOSCONI/HBUS/HSBC@HSBC02  
 CC: ANNE LIDDY/HBUS/HSBC@HSBC02; JANE E MARTIN/HBUS/HSBC@HSBC02  
 Subject: Re: Fw: Received a call from Kathy G this am....

remember my words....absolutely nothing migrates into the FIU or AML Office without proper resourcing, and a full accounting of risk and ultimate consequences of doing so. (Please feel free to quote me on this to anyone you please)

we are in dire straights right now over backlogs, and decisions being made by those that don't understand the risks or consequences of their decisions!!!!

wyn

Wyn Clark  
 Anti-Money Laundering Director | HSBC - North America  
 452 Fifth Avenue, 7th Floor, New York, NY 10018

Phone. 212-525-8025  
 Fax. 212-642-1543  
 Email. wyndham.s.clark@us.hsbc.com

From: Debra L Bonosconi/HBUS/HSBC  
 To: wyndham S Clark/HBUS/HSBC@HSBC02  
 CC: Anne Liddy/HBUS/HSBC@HSBC02, Jane E Martin/HBUS/HSBC@HSBC02  
 Date: 02/26/2010 11:52 AM  
 Subject: Re: Fw: Received a call from Kathy G this am....

yes...it is.

Debra L Bonosconi  
 HSBC North America | Sr. VP - Director, Financial Intelligence Unit  
 1130 Connecticut Ave NW, 12th Floor  
 Washington, DC 20036

Phone. 202-496-8766  
 Mobile. [REDACTED]  
 Email. debra.l.bonosconi@us.hsbc.com

[REDACTED] = Redacted by the Permanent Subcommittee on Investigations

Wyndham S Clark/HBUS/HSBC  
 02/26/2010 11:51 AM

To  
 Anne Liddy/HBUS/HSBC@HSBC02  
 CC  
 Debra L Bonosconi/HBUS/HSBC@HSBC02, Jane E Martin/HBUS/HSBC@HSBC02  
 Subject  
 Re: Fw: Received a call from Kathy G this am....

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Permanent Subcommittee on Investigations

EXHIBIT #6

598

Occ-Psi-00165898

time to push back. any idea who made this decision? is this the same function that takes .3 of an FTE to perform?

Wyn Clark  
Anti-Money Laundering Director | HSBC - North America  
452 Fifth Avenue, 7th Floor, New York, NY 10018

---

Phone. 212-525-8025  
Fax. 212-642-1543  
Email. wyndham.s.clark@us.hsbc.com

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Page 2

Occ-Psi-00165932

From: ANNE LIDDY/HBUS/HSBC  
 Sent: 2/27/2010 10:47:26 AM  
 To: WYNDHAM S CLARK/HBUS/HSBC@HSBC02; DEBRA L BONOSCONI/HBUS/HSBC@HSBC02  
 Subject: Re: Fw: Bco Nac Angola

I re-read this a few times and at first thought it was a bit rambling/venting but that is probably what we need at this point. It is on point, just don't know how we are going to get there. I would point out that we do push back on opening/maintaining relationships that are strategic group relationships and have been able to hold our ground but it is extremely difficult at times - we expend a lot of energy pushing our point and holding our ground and certainly group member referred relationships/transactions have increased our HBUS risk.

HANA is really HNAH.

Also, think you mean to say you can't think of one exception.

Call me if you want. [REDACTED]

----- Original Message -----

From: Wyndham S Clark  
 Sent: 02/27/2010 08:58 AM CST  
 To: Anne Liddy; Debra L Bonosconi  
 Subject: Fw: Fw: Bco Nac Angola

I'm about to send this to Curt and Lesley w/ a cc to Janet and wanted your opinion. Is this on point and accurate, or do I sound like a rambling lunatic?

Wyn Clark  
 Anti-Money Laundering Director  
 HSBC North America  
 452 Fifth Avenue, 7th Floor  
 New York, NY 10018  
 (212) 525-8025  
 wyndham.s.clark@us.hsbc.com

— = Redacted by the Permanent  
 Subcommittee on Investigations

----- Original Message -----

From: Wyndham S Clark  
 Sent: 02/27/2010 08:54 AM CST  
 To: Wyndham S Clark  
 Subject: Fw: Fw: Bco Nac Angola

Lesley and Curt,

This rings to the heart of one of my major issues here. We don't appear to be on the same page as to who owns the risk. My view is the businesses own this risk and should be articulating to their leaders and compliance as to why they are comfortable with it and provide a clear justification how the risk can be effectively managed within the risk tolerances that have been articulated by our BOD. The same goes to group and our affiliates. It does not hold water that we have to open accounts or process transactions just because we are expected to support group mandates. Just like the businesses, my view is that HANA owns the risk, not group, and we have to start acting that way or we will continue to run into problems with no end in sight. If you own the risk, and receive compensation based upon the risk/reward concept, then you have to be prepared to make the decisions necessary to manage it. (Based upon the very upsetting "rewards" process we recently went through in compliance, we are clearly not being compensated on a risk/reward basis in our group.)

The email below, as well as the recent PSI report are good examples. We are spinning our wheels with this PSI report performing scrubs and filing reports where necessary. My view is we should instruct the businesses to review this

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Permanent Subcommittee on Investigations

EXHIBIT #7

Occ-Psi-00165932

report themselves, and report back as to where they have exposure, the risk, and what their action plan is. This should include the highest levels of management in the impacted businesses, and our organization, approving the actions and accepting the risk. Its not what actions compliance is taking, its what actions the risk owners are taking.

At this point the businesses are not accepting that they own the risk, I can think of one exception, making the difficult decisions and taking the necessary steps to mitigate their risk. My view is the risks are being ignored by the business, and they are simply waiting for compliance to tell them what the risks are and to convince them as to what actions need to be taken. If they don't know what the risks are, then why are they opening accounts or continuing with the relationship? They are essentially pushing the risk to compliance, this is not where it resides.

I am happy to discuss this anytime. I'm convinced that our biggest challenges are internal (risk ownership is just one example, my list is lengthy), and until we realize this and get them addressed, we are not going to have an effective AML and/or compliance program. Its time to have an honest discussion with the most senior levels of management in this organization about the issues, until then we're only fixing the symptoms.

I have no problem with either of you sharing this email with those that you feel appropriate. I'm very transparent and candid in my approach, and feel that dealing with issues head on is the best approach.

Thanks,

wyn  
wyn Clark  
Anti-Money Laundering Director  
HSBC North America  
452 Fifth Avenue, 7th Floor  
New York, NY 10018  
(212) 525-8025  
wyndham.s.clark@us.hsbc.com

----- Original Message -----

From: Christopher O'donnell  
Sent: 02/26/2010 08:01 PM EST  
To: Ali Kazmy; Wyndham S Clark  
CC: Anne Liddy; Camillus Hughes; Charles DelBusto; Denis O'brien; James G Holderman; Judy Stoldt; William M Wong  
Subject: Re: Fw: Bco Nac Angola  
Ali/Wyn:

I appreciate the responses and the ongoing analysis, however, we need to be evaluating this and other Angolan clients broadly, versus the specific transaction(s) highlighted in our monitoring. As described in the note from Balance Sheet Management below, we have other businesses who do not have direct relationships with this and other Angolan accounts. They are concerned about their exposure to the counterparties and, as a result, are seeking our guidance.

whereas, its important to highlight all issues and concerns associated with this activity to the business and seek their concurrence, we need to be providing the guidance that is being sought. I don't think anyone involved doesn't already appreciate the risk associated with this business, they are looking for our view. We need to articulate our position and get the view out immediately.

Please let me know as soon as this review is completed. I'm happy to



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Occ-Psi-00165932

participate in any discussion so we can coordinate this view across functions.

CO

-----  
HSBC CIBM IT USA.

----- Original Message -----

From: Ali S Kazmy  
Sent: 02/26/2010 05:51 PM EST  
To: Wyndham S Clark  
Cc: Anne Liddy; Camillus Hughes; Charles DelBusto; Christopher O'donnell;  
Denis O'brien; James G Holderman; Judy Stoldt  
Subject: Re: Fw: Bco Nac Angola  
Wyn,

Thanks for your note.

After completion of the analysis [REDACTED] we intend to highlight all issues/concerns, as applicable, to the business for their confirmation that they are comfortable with the risk.

Shall keep you apprised of developments.

Regards,

Ali S Kazmy  
Vice President/Senior Manager - Anti-Money Laundering Policy | HSBC BANK USA,  
National Association  
452 Fifth Avenue, 7th Floor, New York, NY 10018

Phone. 212-525-5560  
Fax. 212-525-6994  
Mobile. [REDACTED]  
Email. ali.s.kazmy@us.hsbc.com

-----  
[REDACTED] - Redacted by the Permanent  
Subcommittee on Investigations

-----  
From: Wyndham S Clark/HBUS/HSBC  
To: Ali S Kazmy/HBUS/HSBC@HSBC02, Christopher O'donnell/HBUS/HSBC@HSBC02  
Cc: Anne Liddy/HBUS/HSBC@HSBC02, Camillus P Hughes/HBUS/HSBC@HSBC02, Charles G  
DelBusto/HBUS/HSBC@HSBC02, Denis E O'brien/HBUS/HSBC@HSBC02, James G  
Holderman/HBUS/HSBC@HSBC02, Judy P Stoldt/HBUS/HSBC@HSBC02  
Date: 02/26/2010 05:45 PM  
Subject: Re: Fw: Bco Nac Angola

Ali,  
I would advise that we also obtain approval from the head of this business (PCM  
?) that they are comfortable with the risk. I presume the business has some  
sort of risk committee that would review/approve these sorts of  
accounts/clients.

Thanks,

Wyn  
Wyn Clark  
Anti-Money Laundering Director

Page 3

Occ-Psi-00165932

HSBC North America  
 452 Fifth Avenue, 7th Floor  
 New York, NY 10018  
 (212) 525-8025  
 wyndham.s.clark@us.hsbc.com

----- Original Message -----  
 From: Ali S Kazmy  
 Sent: 02/26/2010 05:11 PM EST  
 To: Christopher O'donnell  
 Cc: Anne Liddy; Camillus Hughes; Charles DelBusto; Denis O'brien; James G  
 Holderman; Judy Stoldt; Wyndham S Clark  
 Subject: Re: Fw: Bco Nac Angola  
 Many thanks for your note.

The AML Monitoring Team has been advised [REDACTED]

[REDACTED] They are being reviewed from AML perspective.  
 Moreover, we have spoken with Charles Delbusto and asked that pursuant to  
 established procedures the RM responsible for BNA should be contacted with a  
 request [REDACTED] After completion  
 of the review/analysis [REDACTED], appropriate necessary action, as  
 applicable, will be taken.

Regards,

Ali S Kazmy  
 Vice President/Senior Manager - Anti-Money Laundering Policy | HSBC BANK USA,  
 National Association  
 452 Fifth Avenue, 7th Floor, New York, NY 10018

Phone: 212-525-5560  
 Fax: 212-525-6994  
 Mobile: [REDACTED]  
 Email: ali.s.kazmy@us.hsbc.com

----- = Redacted by the Permanent  
 Subcommittee on Investigations

From: Christopher O'donnell/HBUS/HSBC  
 To: Wyndham S Clark/HBUS/HSBC@HSBC02, Camillus P Hughes/HBUS/HSBC@HSBC02, Ali S  
 Kazmy/HBUS/HSBC@HSBC02  
 Cc: James G Holderman/HBUS/HSBC@HSBC02  
 Date: 02/26/2010 12:56 PM  
 Subject: FW: Bco Nac Angola

All:

Please see email trail below. I want to first make sure you are aware, [REDACTED]  
 you please provide some guidance on how we are addressing, should be be turning  
 this away, etc.

----- Forwarded by Christopher O'donnell/HBUS/HSBC on 02/26/2010 12:35 PM -----

From: Blair Selber/HBUS/HSBC

Page 4

Occ-Psi-00165932  
 To: Christopher O'donnell/HBUS/HSBC@HSBC02  
 CC: Ronald E. Hollmann/HBUS/HSBC@HSBC02  
 Date: 02/25/2010 03:39 PM  
 Subject: Fw: Bco Nac Angola

Chris,

In case we miss each other today, I was calling to discuss if BSM (Money Desk) has any specific instructions when it comes to dealings with Banco Nacional Angola, or for that matter Banco Africano de Investimentos. [REDACTED]

[REDACTED] I discussed with Charlie DelBusto, who assured me that PCM is not under any restrictions relating to the account, and that he did make Compliance aware of this particular transaction.

Historically, these banks have [REDACTED] while we have not dealt recently, what should our procedures be if we are contacted?

Obviously with the headlines around these accounts I just want to ensure we are communicating in both directions with Compliance and following protocol.

Please advise.

Thanks and regards.

Blair Selber  
 Managing Director- Balance Sheet Management | HSBC Bank USA  
 452 Fifth Avenue, 3rd Floor  
 New York, NY 10018

Phone. 212 525 6622  
 Fax. 646 366 3251  
 Mobile. [REDACTED]  
 Email. blair.selber@us.hsbc.com

[REDACTED] - Redacted by the Permanent  
 Subcommittee on Investigations

----- Forwarded by Blair selber/HBUS/HSBC on 02/25/2010 03:27 PM -----

From: Charles G DelBusto/HBUS/HSBC  
 To: Blair Selber/HBUS/HSBC@HSBC02  
 CC: Ronald E. Hollmann/HBUS/HSBC@HSBC  
 Date: 02/25/2010 11:39 AM  
 Subject: Re: Bco Nac Angola

Blair,

I am not aware of any additional reporting requirements, however I did mention this [REDACTED] to Compliance (who happens to be down here with the 9 examiners) and he will look into [REDACTED]

Charles del Busto  
 Global Transaction Banking  
 (T) 302 327 2100  
 (F) 302 327 2128

Occ-Psi-00165932

From: Blair Selber/HBUS/HSBC  
To: Charles G DelBusto/HBUS/HSBC@HSBC02  
Cc: Ronald E Hollmann/HBUS/HSBC@HSBC  
Date: 02/25/2010 11:22 AM  
Subject: Bco Nac Angola

Charlie,

One more follow-up re: the account above.  
Does PCM or anyone make Legal/Compliance at least aware of [REDACTED]  
[REDACTED] Since I am harping on good communication back to us, I  
want to ensure that we are also communicating material changes to them. I  
would think this is in addition to any "typical" [REDACTED] reporting.

Is there someone responsible for that, and was it done in this case?

Thanks again  
Regards

Blair Selber  
Managing Director- Balance Sheet Management | HSBC Bank USA  
452 Fifth Avenue, 3rd Floor  
New York, NY 10018

Phone. 212 525 6622  
Fax. 646 366 3251  
Mobile. [REDACTED]  
Email. blair.selber@us.hsbc.com

[REDACTED] = Redacted by the Permanent  
Subcommittee on Investigations

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From: David W J BAGLEY  
Sent By: Marion O ROACH  
Date Sent: 07/10/2002 12:17  
To: John F ROOY/HSBC/HSBC@HSBC  
Copy To: Sandy Flockhart/HSBC/HSBC@HSBCAMERICAS, Richard E T BENNETT/HSBHA/HSBC@HSBC  
Subject: BITAL

John

I have now met with Sandy Flockhart to discuss the way forward.

The key points are as follows:-

I attach a structure chart (by hard copy), which shows the current, and rather unsatisfactory structures within Bitat.

Sandy acknowledges the importance of a robust compliance and money laundering function, which at present is virtually non-existent.

Before proceeding very far with the search for expatriate resource, Sandy would like someone to visit Mexico with a view to scoping current resources, the extent of the problem, and the major issues. Particularly he is looking to see if there is any local resource which can either be used or groomed to perform the ACO/MLCO role.

Two possible candidates are the existing in-house lawyer at HSBC, and the current ACO. Could you please talk to Carolyn Wind and get her assessment at least on the ACO if not on the in-house lawyer.

There is no recognisable compliance or money laundering function in Bitat at present, and this therefore increases the likelihood that there will be no obvious existing resource which we can use.

Sandy thinks it is important to look both at issues affecting Mexico City, but also closer to the border where there appears to be substantial cross-border flows of monies, including USD in cash.

Sandy is looking for someone to visit mid October onwards, and would like the initial scoping of the extent of the task to be completed prior to closing in early December.

Could I ask you to consider the due diligence, to schedule a trip to Mexico, and once you have some broad dates, contact Sandy with a view to discussing who you would meet, timing etc.

I am happy to discuss further when you have had a chance to consider.

Many thanks

Regards

Permanent Subcommittee on Investigations  
EXHIBIT #8

Redacted Material  
Confidential - FOIA Treatment Request

HSBC OCC 8877797

David

*Encl. by hard copy*

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**e-Documents Note**

This is an image of an email that has been filed to e-Documents.

Any attachments are not accessible from within this image, they can be accessed by navigating to the Document Profile using a browser.

**Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.      HSBC OCC 8877798**

From: David W J BAGLEY  
Sent: Tue Aug 13 15:48:13 2002  
To: Carolyn M Wind  
Subject: HIGH NOON  
Importance: Normal  
Attachments: image\_0.gif; High Noon Report.pdf; ReportAnnex (2).pdf;  
SE51E5A545A3CED480256C1400513AC5.rtf



SE51E5A545A3CED480256C1400513AC5.rtf

Permanent Subcommittee on Investigations  
**EXHIBIT #9**

Confidential - FOIA Treatment Request

HSBC OCC 8873843

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 8873844



## SECTION 3.22

**COMPLIANCE****Background**

A review was performed of the fundamental purpose, current responsibilities and ongoing activities of GFB's Compliance related efforts, with the overall objective being to ascertain the extent of GFB's existing and potential Compliance related risks. A determination was made to assess the effectiveness how GFB's Compliance related efforts are spread throughout the company, including its retail banking network, Cayman Islands and New York City branches, and non-banking units. In addition, GFB has Internet facilities where its clients can perform some banking transactions.

Documentation reviews and staff interviews were undertaken to ascertain GFB's overall effectiveness with Compliance activities and issues. Most of the meetings and interviews were held with Audit officials Rocio Mendoza Ramos, Raymundo Vázquez, Luis Javier Varela Rubio and Arturo Salvador Reyes Figueroa.

**Scope**

The principle focus of the compliance review included :-

- Administrative duties and reviews for opening accounts.
- Know Your Customer practices.
- Money laundering prevention, detection, monitoring and reporting.
- Processes established to adhere with Comisión Nacional Bancaria y de Valores ("CNBV") Circular 1566, which by September 2002 requires all Mexico banks to have internal control policies and procedures to monitor, control and report certain banking risks.
- Policies and procedures congruous to HSBC's Special Categories of Clients.
- Code of Conduct.
- Conflicts of Interest.
- Personal Investment Policies.
- Investor Suitability.

During 1997 and 1998, an account executive was found to have established and operated a money laundering scheme. GFB's case documentation and records were reviewed.

A review was also undertaken relating to GFB's Departamento de Juridico (Legal Department). Refer to the Legal section for a summary of GFB's major lawsuits and client complaints.

GROUP INTERNAL AUDIT  
DUE DILIGENCE REVIEW - PROJECT HIGH NOON

JULY 2002

FindingsStructure

- GFB does not have a Compliance Department. Rather, Compliance work is contained within the scope of activities of the Departamento de Auditoria (Audit Department - INA), which currently has a staff of 100. INA is headed by Flavio Augusto Fraymunt Barreda, who was not interviewed as part of the due diligence effort. Rocío Mendoza Ramos, an INA director, oversees a staff of 30 people, whose responsibilities include Compliance related issues, including operations at the New York agency and assets and liabilities booked at the Cayman Islands branch. Sra. Mendoza said that her area's annual plans include a target goal to review 400 of GFB's 1,329 domestic branches.

Accounting Opening Procedures and Permissible Categories of Clients

- The CNBV issued a regulation in 1998 that requires all Mexico banks to obtain fundamental Know Your Client information. Banks had until 01/01/2001 to bring all accounts opened prior to 05/1997 into adherence with the regulation. INA claimed that all domestic accounts have been brought into adherence with the regulation.
- GFB collects the majority of Know Your Client information from clients. However, new customers are not asked to provide information about their sources of wealth or initial deposit funds. Also, the GFB does not document any information about the expected use of the account or anticipated transaction volume or frequency.
- GFB does not use World-Check list or any other third party databases for new account screening. Also, new client names are not checked against the US Treasury Department's OFAC SDN List.
- GFB does not have a client restriction policy similar to Special Categories of Clients. It has created an internal blacklist called Boletines. Certain government officials, known or highly suspected criminals and criminal enterprises, and persons from the FATF non-cooperative countries comprise the list (although the documentation provided did not have the current FATF list of non-cooperative countries, the list being well over one year old.) GFB's core client information systems compare new accounts with the Boletines and prevents activation of those accounts.
- GFB has a department called Banco Gobierno. This department has as clients selected political individuals; local, state and federal government agencies; and the major political parties. There was no information found indicating whether this department receives any special Compliance related coverage. HSBC would regard the individual and political party clients of Banco Gobierno as high risk SOCs.
- GFB's Casa de Bolsa does not obtain investor suitability information. Clients are required to state their maximum investment volumes based as a percentage of the income information they provide.

Recent reviews of account opening documentation

- FRBNY review in 12/2000 identified that 82 of the 248 accounts reviewed lacked full documentation.

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- A review in 1Q02 (28% sample review of documentation of accounts booked at the target's Cayman Islands branch) found that 41% of the accounts reviewed (92 of 224 reviewed) lacked full client information. 37 files had no client information.
- During 1Q02, INA reviewed electronically inventory records of 73,391 domestic account files. 49,527 (67.5%) of the files contained all of the required documentation. GFB has a 100% goal for 31/12/2002.
- During 1Q02, INA found that the GFB had opened 2,000 USD denominated accounts outside La Franza Fronteriza, violating Circular 2019 of Banxico. The deposit client information system now blocks attempts to open USD accounts outside of the area encompassing land located within 20 kilometers of the US border.

Monitoring Activities

- GFB's main account monitoring efforts are conducted through a system named Monitor. It is a Hogan Tool Kit based system that was built and refined by GFB's INA and IT departments. Monitor's current primary function is to identify accounts whose transactions exceed the equivalent of USD\$0k in any single day. Upon identifying an account that exceeds the daily threshold, the system sends alerts that reach the account executive level, where account managers are to review the alerts and notify INA of any alerts believed to be unusual or suspicious. If an account executive replies that a case is unusual or possibly suspicious, an INA employee opens an investigation and reviews the account's most recent 3 months' of transactions. Discussions are held with the referring account executive as deemed necessary. A case deemed worthy to be sent to the Secretaría de Hacienda y Crédito Público para la Prevención de Actividades Ilícitas, is first sent to the central Comité de Análisis de Operaciones con Recursos Ilícitos ("CAPORI"). The CAPORI has the decision responsibility whether or not to send suspicious activity reports to the government. During 2001, 281 of the 286 cases referred were sent to the government, the residual being considered as not having sufficient merit to report.
- Monitor has columns reporting whether client current account files are documented fully. It reports the information in percentage terms by business division, branch and account executive populations. At the account level, Monitor states whether the fundamental Know Your Client information elements are on file. However, account officers enter this information in Monitor and normally this data is verified only when INA visit a branch, when sample reviews are conducted for file documentation. The system is being enhanced to flag daily activities of more than USD10k for certain accounts.

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The system's merits are that it captures and reports transactions with satisfactory detail. However, its overall application is rather limited :-

- The system does not have any capacity to aggregate transaction activity for any period other than a given day;
- It cannot issue alerts or reports based on weekly, monthly or 3 months' of activity;
- Account officers are responsible to identify and report transactions they believe to be unusual or suspicious. There is no independent review of the over USD30k of activities;
- Monitor is connected only with current accounts on GFB's ledgers. Client Casa de Bolsa and other non-banking transactions are captured by Monitor only if a current account is affected;
- Monitor does not identify high risk clients as such;
- Monitor does not identify the accounts of the Banco Gobierno as such;
- Private banking operations per se, are not identified.

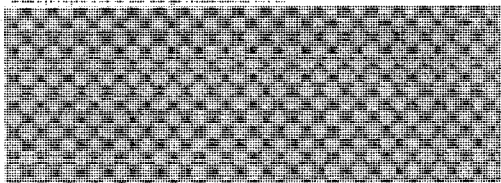
If acquired, it is considered a system such as CAMP Retail would have to be installed and implemented at GFB.

CBNV Circular 1506

- In October 2001, the CBNV issued Circular 1506. The circular requires all Mexico banks to implement internal control policies, procedures and practices by September 2002. The main risks identified are operational, liquidity, credit and money laundering. GFB has developed elaborate policies, procedures and systems to comply with the Circular. All affected areas will have to control, monitor and report regularly their associated risks to the central CAPORI, some areas will have to report monthly. The overall effort is very ambitious, and GFB will be very challenged to be able to adhere to its sophisticated plan.

Money Laundering Case

- GFB was involved in Operation Casa Blanca, a US government undercover sting operation undertaken to combat drug trafficking and money laundering activities in the US and Mexico. A former GFB account executive was found willing to establish fictitious accounts and moved illegal money through them. Despite the fact only the former employee was found guilty of any crime, because of his actions GFB furnished USD3,148,384.40 to the US government in 2002.



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- INA conducted a due diligence review during September 1998 and requested the findings to the Secretaría de Hacienda y Crédito Público para la Procuraduría de Administración México in December 1998.
- GFB forfeited nearly USD3.2m of funds held at three US correspondent banks to the US government in 1998, and [REDACTED] The US government implicated a second individual, [REDACTED] who was a management trainee at the time. [REDACTED] was found to have known about the matter, and he did nothing to stop it or report it to management. However, he was found not to have conducted, or approved, any of the transactions, so GFB was not found guilty by virtue of [REDACTED] actions.
- INA has since conducted money laundering related review work and we are advised by them that no further problems have been found.

Other Compliance Issues

Regulatory Inspections and External Audit Reports

CNBV conducted two inspection visits during 2001. The regulator cited four principle shortcomings with the target bank's money laundering program.

1. No money laundering audits or reviews were performed at the trust area.
2. The overall status of client file documentation was found to be less than satisfactory.
3. Information was missing for 25% of the over USD50k transactions reviewed by the CNBV inspectors.
4. The administration and content of the money laundering training program needed improvement.

GFB management replied that improvement measures would be taken to address each issue noted. However, some issues remain outstanding and not fully addressed (e.g. ML training programme on the Internet).

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The December 2000 Arthur Andersen Management Letter addressed three Compliance issues.

1. Administration and control of credit facilities and contracts with related parties was weak.
2. GFB did not file financial reports and schedules with regulatory authorities in a timely manner.
3. GFB failed to fully implement its risk administration program as called for in its policies and procedures.

Management replied that they had taken the steps necessary to clear each item, but the following should be noted.

1. The 2001 CNBV inspection report listed two large insider loans, and reference to preferential treatment for both which were found to be problem situations. (Refer to the Commercial Credit section 3.3 for further details)
2. GFB has still not fully automated the accounting systems that produce the regulatory reports and schedules.
3. A December 2001 KPMG review of GFB's risk control policies and procedures found that the organization was in compliance with all 31 elements of CNBV Circular 1423, which requires Mexico banks to monitor and control liquidity, credit, markets and operating risks. Banks had to implement procedures to control these risks by 01/01/2001.
4. The 2001 Arthur Andersen Management Letter did not repeat any of the three issues. It did state, however, that the organization needed to implement certain measures to comply with Circular 1423, unlike the opinion rendered by KPMG. We have not received an explanation as to why KPMG were appointed over and above the involvement of Andersen.

Also, the management letter stated that GFB did not have a Treasury Compliance function.

Transactions over the Internet

GFB established an Internet web site in 1996. The bank and Casa de Bolsa have some transactional web site pages. Consumers, small business and corporate banking customers can conduct some account transactions over the Internet, including:

- Purchases of mutual funds shares.
- Tax and other bill payments, including 700 identified service providers and 2 mobile telephone companies.
- Credit card payments.
- Inter-account transfers (business clients only).

GFB has not, however, established web site pages where clients can open new accounts.

During April 2002, some MXP7.7m (USD770k) of unauthorized third party wire transfers were conducted through the Internet, causing a loss to GFB of MXP1.5m (USD150k). To date, the bank has not been able to identify any suspects. We have not seen confirmation that the inherent control weaknesses have been rectified.

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Other Matters

GFB has a Code of Conduct, but it covers very few matters, its overall content being sparse. Conflicts of interest are addressed, but no examples are given and employees are not instructed how to respond to a situation presenting a potential conflict. Other issues, such as outside employment, receiving gifts from clients and service providers, and guidance on responding to attempts of influence, receive little or no attention. All employees were required to attest to understanding the Code and all new hires must also so attest.

GFB does not have a policy relating to employees' personal investment activities, like HSBC's Staff Dealing Rules. If employees purchase stock of GFB they must hold the shares for three months, and one week for other stocks. Employees at the level of director and above must provide personal asset and liability information on an annual basis.

GFB does not have a policy for anti-boycott measures or contract clauses.

GFB apparently does not employ separation of duties between departments for sensitive client transactions, such as the principals of Chinese Walls for investment banking and merger and acquisitions activities. During some interviews with other DD team members, some GFB officials referred to the concept of Chinese Walls, however, it appeared that they were using the term to note separation of duties between front and back offices.

Conclusions

The GFB Compliance effort is weak, and it appears that the target organization does not have a strong Compliance culture.

- GFB does not, in reality, have a Compliance Department and one would have to be established and implemented, with possibly some local staff being transferred from IMA. It is likely that, in the event of the acquisition proceeding, HSBC would need to import an experienced Compliance official establish a formal department.
- Reviews of account opening procedures and client documentation are sporadic, and the reviews normally do not encompass large populations of client files or activities. This effort needs to be strengthened.
- Client transaction and activity monitoring is very limited. The reliance on account managers to identify and report unusual and suspicious transactions of their clients is a serious internal control shortcoming. Historical analysis of possible suspicious situations are performed only at the recommendations of account officers. High risk clients receive no special monitoring coverage. The organization permits accounts of individuals and organizations that are considered high risk by some banking organizations and simply not permitted by others. Yet, there are no special efforts to monitor activities or perform special reviews of these clients. Enhanced transaction monitoring, especially for high risk clients and unusual activities, would have to be injected to the effort. Quite likely the increased monitoring activities would require additional staff.

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- Internal and external audit recommendations, and issues raised in regulatory reports do not receive proper respect and action. Many replies to exceptions and recommendations are merely perfunctory, and committed improvements are often slow in forthcoming. At times management has not responded at all to issues and recommendations cited in Internal Audit reports. For example, we identified no records where INA or another department performed any follow up reviews to the matter cited by the FRBNY examiners. Business lines and support areas would have to dedicate efforts to address and resolve audit and regulatory issues and recommendations.
- The shortcomings with monitoring account opening practices, client transactions, unusual operations, and the lack of follow up to exceptions and recommendations cited in audit and regulatory reports, present the potential to have a neither employee or group of employees become involved in another money laundering operation.
- Measures to promote and ensure staff discipline are not satisfactory. GFB's Code of Conduct lacks content, detail and spirit. There is no policy to promote prudence with employees' personal investment activities. Appropriate staff related policies would have to be implemented immediately as part of the overall effort to install a dedicated Compliance and internal control culture throughout the organization.



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From: David W J BAGLEY  
 Sent By: David W J BAGLEY  
 Date Sent: 13/08/2002 15:48  
 To: Carolyn M Wind@HSBC@HSBCAMERICAS  
 Copy To:  
 Subject: HIGH NOON

Carolyn,

As promised.

Could I leave you to pass this on to Paul in a secure fashion.

Regards

Forwarded by David W J BAGLEY@HSBC on 13 Aug 2002 15:44

Memo  
 13 Aug 2002 14:48

From: Matthew J W KING/GQM INA GHQ/HQ/HQ/HSBC

Tel: 790 50247

44 20 7200 9247

0549 5424 031 1052

Sent by: Liz A TESTER

To: David W J BAGLEY@HSBC@HSBC

cc:

bcc:

Subject: HIGH NOON

Copy of report as requested.

Matthew King



High Noon Report.pdf



Responses (2).pdf

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HSBC OCC 8873854

**e-Document's Note**

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Any attachments are not accessible from within this image, they can be accessed by navigating to the Document Profile using a browser.

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HSBC OCC 8873855

From: John F ROOT  
 Sent By: John F ROOT  
 Date Sent: 25/11/2002 09:37  
 To: Richard E T BENNETT/HSB M ISBC@HSBC, Matthew J W KING/GGM INA  
 GHQ/HQ/HSBC@HSBC  
 Copy To:  
 Subject:

Attached please find a report on my visit to Bilal, a report which Sandy Flockhart has already seen.

There is very little of what we would call a Compliance function. Also, I have left out personal evaluations because of the sensitivities involved. I did not encounter anybody at Bilal who I thought immediately capable of building a Compliance department. However, I met with Ramon Garcia Gibson, Director of Anti-Money Laundering at Banamex (Citigroup), and I agree with Matthew (and Susan Wright) that he would be a good candidate to head Compliance in Mexico.

Kind regards,

John Root



Bilal Visit 4-8NOV02.doc

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Permanent Subcommittee on Investigations  
**EXHIBIT #10**

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COMPLIANCE DUE DILIGENCE TRIP BY JOHN ROOTBITAL (MEXICO CITY) - 4-8NOV02

NOTE: *The information in this report was obtained through management interviews and has not been independently verified.*

Background

The Mexican economy is largely cash-based. Workers even have the right to receive wages in cash. Prior to 1996, an identification was needed to open an account. One HSBC Mexico manager opines that, in Mexico, a false driver's ID can "be obtained in two hours". The same manager notes that "Mexicans don't like to disclose financial information" and that they "will open an account in the name of the mind".

As more than one senior manager opined, there is a lack of a "control culture" at Bital.

Laws

A number of banks are currently working together on drafting a compendium of banking laws, which would be useful for the Compliance Chart.

Action: the Bital Chief Legal Counsel to participate in the working group and obtain a copy of the compendium for the Compliance Chart. Target date: to be determined.

There is no law requiring "public interest" loans - be they for agricultural or other favoured sectors, or for poorer regions or urban areas. However, last month the Banco de Mexico requested that Bital make a USD 1.5 billion deposit with them at a preferential rate.

Government Relations

One of Grupo Bital's chief regulators, Mr Carlos Provencio Munoz, an Assistant Director General at Hacienda (the Treasury), was extremely critical of Grupo Bital. Perhaps it is best to quote at some length Mr Provencio's own words.

Mr Provencio said that controls ("la area normativa") "do not exist" - an assertion which he repeated a number of times and in which he included legal and internal audit controls. They "carry no weight" and "do not pass the test". There is "an unacceptable level of client complaints" (See the section immediately below on "Client Complaints"). The regulators themselves receive "many complaints". He suspects that Banco Bital "was bilking the clients for liquidity" [sic] and that its "record was worse than other banks".

Banco Atlantico is a "complicated situation". Banco Bital does not accept Atlantico bank customers or their problems, Mr Provencio continued, even though it has the legal responsibility to do so.

Mr Provencio reserved some of his harshest criticism for Grupo Bital's Legal Department, which he averred was "not guilty of bad faith but extreme ineptitude". He stressed the need for better controls of civil cases, where the group's lawyers were often unprepared and missing the proper documents. He cited several examples but said they were "not isolated cases". One case in particular bothered Mr

Provençio (besides the well-known lawsuit of the Banco Atlántico client whose interest payments spiralled out of control and reached the millions). The current head of the Legal Department told Mr Provençio that a cashier had paid money out to a complaining client – and the hapless department head therefore considered the “case closed”. Unfortunately, Bital apparently couldn’t produce a proper time-stamped receipt, and the client continued to complain to the regulator, who blamed a “bad teller system” which, “while not reaching the level of institutional misbehaviour, can’t say what went on to whom and when.”

There’s a bit more. “Bital needs a proactive strategy.” It also needs “sweeping changes in management”. “There is a lot of work to do.” “There is no ability to prevent problems.” “Today there is no balance between the client and the bank.”

Mr Provençio ended with a warning about the need to plan very carefully any systems migration.

Senior management’s defence is that relations with the regulators have been soured by two issues in particular: Bital’s capital needs and the Atlántico acquisition.

*Action:* Faced with such a troubled regulatory relationship, it is suggested that senior management make a concerted effort to meet frequently with Mr Provençio to keep him informed of progress made in controls, particularly in the Legal Department. Bital’s Head of Compliance, when designated, should be the person responsible for co-ordinating such an effort. Target date: continuous.

#### Client Complaints

Complaints increased significantly in 2002, averaging 4-5 thousand a month.

There is a centralised system of client complaints called Servital. It can sort complaints by type, region, and client category (A,B,C...).

Major causes of complaints are: ATM malfunctions, payroll errors, bad service, delays in the credit process, check frauds (including for tax payments), and late credit card statements.

The level of client complaints can affect significantly the variable portion of managerial salaries.

Regulators have been highly critical of Bital’s client service. (See the section immediately above on “Government Relations”)

#### Litigation

Despite a high level of complaints, there is relatively little litigation against the bank. The Legal Department oversees mostly the collections procedures in the courts.

A few states are known to be particularly debtor-friendly: Chihuahua, Morelos, Tamaulipas, and Durango. This is a problem because, while banking is regulated on the Federal level, collection procedures are governed by state and local regulations.

IPAB, the Institute for the Protection of Bank Savings, audited Fehapra scores (Fehapra is a predecessor bank savings protection fund which purchased certain assets of Mexican banks after the 1994 crisis) and returned ones it deemed in contravention of the bail-out regulations. Legal proceedings were instituted against the government fund by Bital, Guadimex (owned by Citigroup), Bancomer (owned by BBVA) and Banorte. A settlement is considered imminent.

#### Fines

Bital was fined USD 400,000 and Atlántico USD 300,000 for failure to respond adequately and on time to government requests for information on 1994 crisis programmes. One difficulty had been the

reconciliation of discount/interest rates applicable in such programmes.

There have also been fines for the closing of branches.

The bonding company Fianzas has had a historically high level of fines.

#### Money Laundering Controls

Senior management, perhaps because of recent liquidity concerns, can monitor client transactions, including cash deposits and withdrawals, through an IT system called Cierre Diario (Daily Closing).

Cierre Diario contains previous-day information, and is updated in a batch process (i.e., not in real-time).

The system can filter accounts and transactions in different ways (by account, region, branch, amount, etc.). It can scan all accounts.

Senior management's practice is to monitor transactions greater than MXP 4 million (USD 400,000).

The minimum legal requirements for money-laundering controls are three-fold:

- 1) a system to identify the clients of high-risk transactions
- 2) quarterly reporting of monthly cash deposits of at least USD 10,000 or the equivalent
- 3) a monitoring system for lower-income clients who deposit at least USD 10,000 monthly

A senior HSBC Mexico manager has some doubts as to how closely the regulators investigate reported transactions, as HSBC Mexico receives few substantive comments or questions on the information submitted.

Cierre Diario was developed as an MI tool rather than for money-laundering prevention. The main IT system used by Bital to comply with the above minimum legal requirements is called "Monitor". Monitor is a customised system built with the Hogan Tool Kit.

Primary responsibility for the detection of unusual transactions through Monitor rests with the Dirección de Auditoría de Seguros, an area within Internal Audit. The Capori committee (see below) is informed, and the account executive is asked to investigate and take appropriate action. This self-regulation is a significant weakness in controls.

Monitor filters and records all daily client transactions that total USD \$9,000 or more.

In 2001 281 suspicious transactions were reported to the authorities totalling over MXP 1.75 billion (USD 175 million). YTD 2002, 162 suspicious transactions were reported, totalling over MXP 900 million (USD 90 million).

A committee called Capori (Comité de Análisis de Operaciones con Recursos Ilícitos) monitors suspicious transactions. This committee, which is composed of a representative nominated by each of the heads of Audit, Legal, Operations, Fraud Prevention, and Banking, meets monthly. The Committee secretary is a member of the Seguros area of Internal Audit.

The Capori committee also monitors the implementation of the internal control requirements of CNBV Circular 1506. (The CNBV, Comisión Nacional Bancaria y de Valores, is a regulator. Its prime responsibilities include the regulation of securities.) The main risks identified in this circular are operational, liquidity, credit, and money laundering.

There are 5 regional Capori committees, which report to the central headquarters Capori. It is this Capori at Bital headquarters which determines which suspicious transactions will be reported to the regulators (Hacienda and CNBV).



There is a confidential "whistleblower" telephone number for unusual transactions. The programme, called Copartel, has to date permitted the reporting to the authorities of 7 suspicious transactions totalling MXP 1 million (USD 160,000).

All account records must be kept a minimum of 5 years.

It is claimed that all staff received money-laundering training. However, the exact nature of this training must be verified. The CNBV noted in a 2001 inspection that the administration and content of the money-laundering training programme needed improvement. It does not appear that this recommendation has been fully implemented.

#### Correspondent Banking

Banco Bital has active correspondent banking relationships with 20 banks. These banks appear to be well-known and reputable institutions.

Banco Atlantico does not have separate correspondent banking relationships, except in Miami, where there is an account with Banco Bital itself.

Banco Bital has 85 correspondent banking relationships in total most with well known banks - and none with banks in FATF non-cooperative countries.

Among those banks requiring further KYC are:



HSBC wants to exit the relationship.

*Action:* Bital's Head of Compliance, when designated, will monitor enhanced KYC on all correspondent banking relationships, but particularly on the above banks. In the absence of satisfactory KYC, the Compliance head will recommend to senior management the exiting of the relationship. Target date: 31 MAR03.

An average of USD 200 million is wired out of the country every month in 8,300 operations. An average of USD 357 million is transferred to Mexico in 19,000 operations.

Each account executive has to sign off on the KYC documentation, including for the Grand Cayman operations.

All international wire payments are subject to the Monitor system, which does not currently block any transaction, or even use any filter other than the USD values described above. The suspicious activity reporting procedure is the same as elsewhere in the bank (see above "Money-Laundering Controls").

As indicated, Bital does not have as a filter the FATF non-cooperative country list. Mexican banks are "discussing a common position" on the issue.

There are automatic quarterly reports to the regulator (CNBV) of all transactions greater than USD 10,000.

*Action:* Bital's Head of Compliance, when designated, to develop, and Operations to implement, a group-wide filter for suspicious transactions, including the use of the FATF non-cooperative countries list and the Group high-risk countries list. Compliance will also develop and implement a process to investigate suspicious transactions and take remedial action without any tipping-off. This system will

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be developed group-wide for all account activity, not just correspondent banking. Target date: 30JUN03.

As elsewhere, many correspondent banks do not identify the ordering party of a wire transaction. However, early next year Swift in Mexico will switch to Form 103, which does require such identification.

Bital's two main U.S. correspondent banks are [REDACTED]

Bital has total correspondent banking deposits of USD 1.5 billion, including offshore deposits of USD 700 million in Grand Cayman and USD 145 million in New York. The remaining USD 674 million is on deposit in Mexico.

*Action:* Bital's Head of Compliance, when appointed, will analyse all correspondent banking deposits, but particularly those in the Cayman Islands. Target date: 30JUN03.

Bital gave the requisite USA Patriot Act certification.

#### Foreign Exchange

Bank policy is not to transact business with foreign-exchange shops ("caseros cambiarios") which only exchange foreign currency – but do not transfer money. These "caseros cambiarios" – of which an estimated 5,000 exist in the country – are lightly regulated. On the other hand, Banco Bital does do business with bureaux de change ("casas de cambio") which transfer money and are better regulated.

#### Tax Payments

In Mexico the banks are obligated to process tax payments – which are made almost entirely by check. The banks obtain lucrative government business in exchange for their co-operation. (See the section on "Government Business")

The tax collection system is very inefficient and organised fraud is widespread. The banks have successfully lobbied the government to require Internet payments from legal entities and, for larger anonymous individuals (with earned income greater than MXP 1 million, or unearned income greater than MXP 300,000). In addition, certain other taxpayers (i.e., those required to make monthly withholding payments) must make electronic payments. Pending legislation will further expand electronic payments.

In order to reduce fraud, electronic payments should be maximised, where required or permitted by law, regulation, and the services contract signed between Bital and Hacienda.

*Action:* Bital Legal and Operations to review all pertinent legal and contractual provisions and develop further the electronic and Internet payments systems by taking advantage of every opportunity provided by law, regulation, or contract. Target date: 31MAR03.

#### Government Banking

Bital provides banking and payroll services to government at the Federal, state, and local levels. In addition to making loans to state and municipal entities, Bital processes payrolls for government employees (and deducts from their pay instalments on consumer and mortgage loans); advances funds for the payment of suppliers; and manages government deposits – including large judicial deposits and deposits for state-controlled entities such as [REDACTED]

Clearly the preponderant role of the state in the banking sector means that any business proposal is one element in a vast and complex overall relationship. There is a lot of haggling, in part because free and consultations can be politically unpalatable (and the government does not have the appropriate line

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item in its budget). Often the bank's remuneration for a service will be indirect, perhaps through a large deposit at a favourable rate or opportunities to market products to state employees on a captive payroll. (See sections such as "Laws", "Government Relations", and "Tax Payments")

#### Private Banking

Mexican law does not permit the solicitation of fiscal transfers abroad, although there are no restrictions *per se* on such transfers.

*Action:* Bital Legal to develop practical guidelines on what is and is not allowed in Private Banking.  
Target date: 31MAR03.

*Action:* Bital's Head of Compliance, when designated, to review all existing Private Banking, with particular attention to USD accounts and fund transfers to New York and the Cayman Islands.

#### Trusts

The trust area has experienced many difficulties. Formal documentation is often lacking. Proper accounting for tax payments is a problem (e.g. for foreigners who can only own property on the land borders and constables through a trust).

The area should improve with the recent installation of new IT systems.

#### Labour Unions

The main labour union is the Federación de Sindicatos Bancarios, to which 6,500 Bital employees belong - "mostly tellers".

Labour relations are considered good. Three cases support this claim. First, the radical Barzon movement, which demonstrates - sometimes violently - for debt-relief for poor farmers, has not usually targeted Bital branches. Second, branches have been kept open longer throughout the country with little protest from the unions. Third, management convinced the unions to accept significant job losses when Atlantic branches were closed - in part because Bital was expanding so rapidly elsewhere.

#### CCF

One senior manager noted "a lot of walk-in CCF business". This is curious because CCF's formal involvement with Latin America ceased over two years ago and, as far as Group is aware, CCF never had much business in Mexico anyway.

*Action:* Bital's Head of Compliance, when appointed, to investigate all CCF-originated business.  
Target date: 31MAR03.

## INFORME GENERAL DE AUDITORIA

HBMX GAQ 040026

COMPLIANCE - MONEY LAUNDERING

AUDITORIA INTERNA DEL GRUPO

MAYO 2004

Riesgo	Auditoria Actual	Auditoria Anterior
Riesgo Intrínseco	High	N/A
Riesgo de Control	Below Standard	N/A
Riesgo General	High	N/A

HBMX GAQ 040026

Página 1 de 1

MAYO 2004

Permanent Subcommittee on Investigations

EXHIBIT #11

Confidential - FOIA Treatment Request

HSBC OCC 8874376

**I. RESUMEN EJECUTIVO****I.1. Antecedentes**

El objetivo de este informe es el detallar las observaciones detectadas en la revisión de Lavado de Dinero realizada a HBMX.

En México las Instituciones de Crédito están obligadas a dar cumplimiento a las disposiciones de la Secretaría de Hacienda y Crédito Público (SCHP) para prevenir, detectar y reportar operaciones con recursos de procedencia ilícita, establecidas principalmente en el artículo 115 de la Ley de Instituciones de Crédito (LIC), donde se definen:

- Operaciones relevantes. La que se realice en cualquier instrumento monetario por un monto igual o superior a USD 10,000
- Operaciones inusuales. Transacciones realizadas por personas físicas o morales, que no sean congruentes con la actividad o giro comercial del cliente, por su monto, frecuencia tipo o naturaleza.

Dentro de la Dirección Ejecutiva de Compliance se encuentra la Dirección de Prevención de Lavado de Dinero a cargo de Carlos Rochun Álvarez desde hace 1 año, teniendo dentro de sus principales funciones:

- Asesoría y apoyo al grupo para el cumplimiento de las de la normatividad anti-lavado de dinero.
- Controlar cambios en prácticas y productos asegurando los controles de prevención de lavado de dinero.
- Controlar el cumplimiento de los procedimientos y controles de prevención de lavado de dinero.
- Apoyo en la capacitación en materia de lavado de dinero en el grupo.
- Proporcionar al personal del Grupo los medios y mecanismos para el reporte de las operaciones relevantes e inusuales.

El área se encuentra integrada por 1 director, 2 subdirectores, 5 gerentes y 5 analistas

**I.2 Objetivos de Auditoría**

Evaluar que los mecanismos utilizados para el monitoreo y detección de operaciones relevantes e inusuales sean suficientes para proteger la buena reputación de HBMX.

Evaluar el control interno de la Dirección de Prevención de Lavado de Dinero verificando:

- Estructura.
- Análisis de procesos
- Manuales de políticas y procedimientos.

Evaluar que los mecanismos de reporte de operaciones a las autoridades sean oportunos y suficientes para cumplir con las regulaciones establecidas.

Identificar productos de riesgo y verificar que estos sean monitoreados adecuadamente.

Verificar que el grupo cumpla con las leyes y circulares establecidas para la prevención de lavado de dinero.

### 1.3 Alcance de Auditoría.

La auditoría se realizó al Grupo HBMX incluyendo HHM1 y filiales, y consistió en:

Se verificó la estructura del área a través de organigrama y descripción de puestos

Se realizaron entrevistas con el personal del área identificando sus funciones, mismas que fueron analizadas y evaluadas.

Se evaluó el sistema MONITOR utilizado para el monitoreo de operaciones relevantes.

Se revisaron 17 expedientes de casos reportados por Banca.

Se evaluaron los procesos de:

- Reporte de operaciones a las autoridades.
- Análisis de operaciones inusuales reportadas por las sucursales.
- Monitoreo de operaciones
- Operaciones relevantes
- Atención de oficios de la CNBV

Se verificó el cumplimiento de las principales leyes y circulares aplicables:

Se analizaron los procesos de control para prevenir operaciones de lavado de dinero en las filiales: Casa de Bolsa, Seguros y Fianzas.

A través de entrevistas se identificaron los procesos en los que se consideró se tiene mayor riesgo de incurrir en operaciones de lavado de dinero y se evaluó en ellos los mecanismos de monitoreo, en las siguientes áreas o filiales:

- Fiduciario
- Cartera
- Operaciones Pasivas ( Remesas, Cobro inmediato, Ordenes de pago, Inversiones, Logística Monetaria y Aclaraciones)
- Banca por Internet
- Compra-Venta
- Cuentas Gran Caimán
- Casa de Bolsa HSBC
- HSBC Fianzas

- HSBC Seguros
- HSBC Pensiones
- Aseguradora Atlántico
- HSBC Vida

Se identificaron indicadores de los productos con riesgos de lavado de dinero.

Se dio seguimiento a las observaciones emitidas por las autoridades en el último año.

#### 1.4 Conclusiones

HBMX has insufficient controls to detect money laundering transactions in all areas of the Group in a timely manner. The implementation of the CAMP system is in process yet it only includes the Bank's transactions that have been registered in the Hogan system and fails to monitor those registered in other IT systems / HBMX subsidiaries.

Dirección de Prevención de Lavado de Dinero [Direction of Money Laundering Deterrence] has identified high-risk areas of money laundering transactions, which are not being monitored.

The communication between LCOs and Compliance does not enable the timely detection of the needs and weaknesses of the areas and subsidiaries.

There are inadequate internal controls over the IT systems used to send information to the regulator on suspicious or relevant transactions to authorities.

In our opinion, based upon the foregoing, the Direction of Money Laundering Deterrence is operating with a **BELOW STANDARD** level of Control Risk.

Our principle conclusions are as follows:

#### INTERNAL CONTROL

The principle weaknesses identified in the administration of personnel include the inadequate segregation of duties as the departmental structure is top heavy (1 director, 2 sub-directors, 5 Managers and 5 Analysts).

The internal manual and regulatory circulars are not updated on a timely basis.

There is inadequate handling and safeguard of relevant and suspicious transactions. The Sub-director and the personnel reporting to him share the password that is used to access the SITI system and send information to the authorities. The restricted area used to store records of suspicious transactions is not always kept safe.

**RELEVANT/SUSPICIOUS TRANSACTION MONITORING**

HBMX monitoring tools in place do not ensure that all relevant / suspicious transactions are reported, since only the transactions registered in Hogan are monitored, this is not the case for transactions entered through the Bank's other IT systems. The information relating to subsidiaries is not validated before it is sent to the authorities. The information that was incorrectly included by the system has to be manually eliminated before it is sent to the authorities.

There is a high risk of exposure in the detection of suspicious transactions, for they are detected only through banking lines. The internal controls for money laundering deterrence do not include Group areas or subsidiaries. The auditors noted that MONITOR system, which is the only suspicious transaction indicator, has not received maintenance for the last 3 years and the information contained therein has not been used for money laundering deterrence.

**Added-Value Recommendations:**

- Although there is a project to implement the CAMP system in HBM, it is also necessary to develop systems to monitor transactions in other businesses of the HBMX group using indicators and trends in high-risk products and areas and raising alerts in order to take immediate actions.

**1.5. Recomendaciones Principales****Recursos Humanos**

Vigilar que las funciones inherentes a la subdirección de medición y control se realicen de acuerdo a lo establecido por el área y caso de que el personal no cumpla con el perfil ponerlo a disposición de recursos humanos (3.1.1.).

Establecer una adecuada segregación de funciones.

**Manuales y circulares**

Incorporar en el manual de prevención de lava de dinero procedimientos para el tratamiento de clientes de alto riesgo, perfiles de transacciones de clientes y visitas domiciliarias. (3.1.2.)

**Sistema Monitor**

La administración del sistema debe entregarse a la dirección de prevención de lavado de dinero.

Establecer validaciones del sistema que verifique la información capturada en las bitácoras

Establecer un registro de los usuarios que consultan la información del sistema

Establecer mecanismos que permitan identificar todas las operaciones relevantes.

Aun cuando se tiene el proyecto de implementar el sistema institucional CAMP, es



necesario establecer medidas que permitan monitorear las operaciones adecuadamente en lo que se termina el proyecto. (3.2.1.)

**Operaciones Relevantes**

Deben de establecerse sistemas que permitan reportar todas las operaciones relevantes del grupo

Realizar un análisis del Set de transacciones de Hogan verificando que todas las transacciones en efectivo estén incluidas en el reporte de operaciones relevantes.

Es importante que antes de que se reporten las operaciones relevantes de las empresas filiales se verifique la información. (3.2.3.)

**Operaciones Ixuxuales.**

Establecer las medidas necesarias para evitar la utilización de la red del Grupo con el objeto de lavar dinero ( GSM 5.7), estas deberán de considerar todas las filiales y procesos de HBMX.

Establecer junto con el área de operaciones mecanismos que permitan controlar y monitorear los usuarios y bienes de las cajas de seguridad.(3.2.4.)

**Nuevas Disposiciones en materia de lavado de dinero**

Establecer planes formales y fechas compromisos para dar cumplimiento a cada una de las resoluciones mencionadas en las Disposiciones.(3.4.1.)

From: Marion O ROACH  
 Sent: Fri Jan 21 16:08:02 2005  
 To: Stephen K GREEN  
 Cc: Richard E T BENNETT  
 Subject: COMPLIANCE EXCEPTION  
 Importance: Normal

Stephen

There are two matters which I should briefly draw to your attention given their seriousness and potential repercussions. These are:-

We have received a serious disclosure via the Group Disclosure Line where 3 members of the Compliance function within HBMX have alleged that senior persons within the Compliance function fabricated records of certain mandatory anti-money laundering meetings and provided these to the local regulator, CNBV. It is alleged that, when asked for copies of evidence that the meetings had occurred as required by local regulation the relevant Compliance Officers realised that the meetings had not taken place, and fabricated attendance sheets purporting to be signed by relevant attendees for at least 4 meetings. After discussions with Sandy Flockhart it has been agreed that Graham Thomson, Head of Audit in HBMX will investigate the allegations in association with GHQ CMP (given the need to demonstrate that the Disclosure Line and procedures are being followed) and a report will be provided in due course. It is too early to reach any conclusions with regard to the allegations or the possible outcome of the investigations. HBMX are aware of the need to protect the identity and positions of those lodging the allegations.

As you are aware HBUS operates a Banknotes business through a variety of branches, including a branch in SGH. It appears that in December HBUS SGH booked two transactions for the physical purchase of US Dollars in the amount of USD2.9m from [REDACTED]. The transaction was slightly unusual in that whilst we had a selling relationship with [REDACTED] we had not previously purchased notes from them. When further explanations were sought we were advised that the [REDACTED] had received the notes on behalf of [REDACTED] who in turn had sold machinery to the [REDACTED]. Myanmar is currently subject to OFAC regulations prohibiting any transactions by US persons relating to Myanmar counterparties. The individual relationship manager acted without knowledge of the branch manager, and the nature of the transaction, and the parties involved was identified as a consequence of routine compliance monitoring in January 2005.

There appears little doubt that the transaction is a breach of the relevant OFAC sanction on the part of HBUS, that it will need to be reported to OFAC and as a consequence there is a significant risk of financial penalty. It does not appear that there is a systemic issue, rather we are dealing with an individual incident, although given the potential seriousness of the breach external lawyers have been instructed to assist with the process of resolving matters with OFAC.

I will of course ensure that appropriate reports are included within GMB and GAC papers, although with regard to the first of the above two incidents I think it would be appropriate to await the outcome of the investigation before including details of the ongoing investigations so far as GMB is concerned. I will report in full to GAC in relation to both incidents at the February GAC meeting.

David Bagley

Permanent Subcommittee on Investigations

EXHIBIT #12

Redacted Material  
 Confidential - FOIA Treatment Request

HSBC OCC 8873671

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INTENTIONALLY  
LEFT BLANK

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 8873672

From: Marion O'ROACH  
 Sent: Wed Feb 16 11:56:55 2005  
 To: Stephen K GREEN  
 Cc: Richard E T BENNETT  
 Subject: DISCLOSURE LINE - HBMX CMP  
 Importance: Normal

Stephen

I refer to my note of 21 JANOS where I gave initial notification of the serious allegations received via the Disclosure Line. The disclosure made by three members of the Compliance function allege that senior persons within the Compliance function fabricated records of certain mandatory anti-money laundering meetings and provided these false records to the local regulator CNBV.

It was agreed with Sandy Flockhart that these allegations should be investigated by the local audit function in association with GHQ CMP.

The final report has been received which confirmed the following:-

The relevant mandatory monthly meetings had not been held between July and December.

Attendance sheets and minutes were fabricated to disguise the fact that the meetings had not taken place. False records were produced in response to a request from CNBV (received during a routine examination) for sight of the relevant minutes and attendance sheets.

Two junior employees admitted involvement and knowledge of this fabrication albeit acting under instructions from Carlos Roshin (CR) the former Head of Money Laundering Detachment within HBMX.

CR admitted giving the relevant instructions and to being solely responsible for the fabrication. To his credit CR was entirely open and candid in responding to questions and immediately tendered his resignation. This was accepted.

Ramon Garcia (RG), the Head of HBMX CMP was unaware of the fabrication, but was found to be culpable given that he had failed to ensure that the relevant meetings had taken place, particularly as he had been designated chairman of the relevant committee. RG has been given a final written warning, and will not receive any bonus or salary increase for the year ended 2004.

CNBV have been advised and it is not expected that any action will be taken. It has been agreed that I should advise FSA in a low key manner which will then hopefully close matters.

The need to closely oversee, supervise and indeed support RG on an ongoing basis is recognised and we will do what we can from GHQ CMP to assist in this regard. Overall RG has performed credibly, has worked very hard, and would otherwise be hard to replace. In the circumstances whilst we will need to keep his position under review at this stage I endorse the decision to retain his services given that his failure is limited to one of failing to supervise a very senior and trusted subordinate.

I will provide an appropriate report to GAC at the next meeting.

David Bagley

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HSBC OCC 8873673

From: John F ROOT  
 Sent: Fri Dec 02 15:53:15 2005  
 To: David W J BAGLEY  
 Cc: Marion O ROACH  
 Subject: Re: OFAC  
 Importance: Normal

Redacted by the Permanent  
 Subcommittee on Investigations

David

Taking your queries in order:

Transactions of government missions in the United States are exempt from the US Transactions Regulations (commonly referred to as the "OFAC sanctions") provided that they are related to the import or export of goods and services which "are for the official business of the mission", or for the personal use of personnel admitted to the United States under [a special immigration section] and the transactions are "not otherwise prohibited by law". (31 CFR 560.512) There is no definition in the statute as to what constitutes "official business" of a mission or "personal use".

Ramon told me that only two embassies -- out of all the embassies they do business with -- have USD accounts in the Cayman Islands. They are: [REDACTED] He did not volunteer an explanation, but perhaps he didn't think that one was necessary. He seemed somewhat constrained so I did not press him further.

The challenge is to determine whether a transaction is for "official business". There have been a number of media reports in serious newspapers of [REDACTED] embassies

misusing their diplomatic status for alleged funding of alleged terrorist activities -- in particular through their "Islamic interests" sections. Their defence is that the funding is for legitimate charitable Islamic purposes such as the funding of mosques. Some Western authorities allege more sinister purposes, e.g. the funding of terrorist Hizbollah activities in the case of [REDACTED]. At the very least, Group rats being caught in the midst of a highly visible and passionate polemic, a polemic which sadly has already caused a lot of bloodshed and pain.

I hope the above helps. I would be glad to discuss further with you at your convenience.

Kind regards,

John Root

David W J BAGLEY/HQHQ/HSBC

David W J BAGLEY/HQHQ/HSBC HQHQ Sent To: John F ROOT/HQHQ/HSBC@HSBC

Permanent Subcommittee on Investigations

EXHIBIT #13

Redacted Material  
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A. HSBC OCC 8876612

by: Marion O ROACH 02/12/2005 12:22 Phone

No. 7991 8645

44 2079 918645 Mail Size: 3031

cc

Subject OFAC

ct

Entity HSBC Holdings plc - HGHQ

John

As you may recall HBMX maintained accounts for the [REDACTED] in their Cayman branch.

It looks like I will be participating in a conference call involving HBMX, Jeremy Barton and myself early next. I suspect, although do not know, that this conversation will include some debate as to whether these accounts can be maintained, with presumably Jeremy Barton putting the case for retention based on relationships with [REDACTED]. Whilst I understand this, in advance of the conversation I would like to be armed with the following information if at all possible:-

Are transactions [REDACTED] exempt under OFAC - or do we in the same as any other set of transactions involving [REDACTED] need to determine whether each individual payment is exempt, including judging for U-turn exemptions.

Without troubling Ramon further, are we aware of any particular reason why [REDACTED] - for example do they have a diplomatic presence there?

Unless I am missing something the maintenance of a USD account for an [REDACTED] raises challenges for us - am I missing something?

Regards

David Bagley

Redacted Material

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From: Graham THOMSON  
 Sent: Thu Mar 22 16:13:38 2007  
 To: David W. J. BAGLEY  
 Subject: Fw: [REDACTED]  
 Importance: Normal  
 Attachments: image\_0.gif; image\_1.jpg; image\_2.jpg; image\_3.jpg; image\_4.jpg; image\_5.jpg;  
 image\_6.jpg; image\_7.jpg; image\_8.jpg; image\_9.jpg; image\_10.jpg; image\_11.jpg; Doc Link.htm;  
 [REDACTED] AML\_March2007.doc

Graham Thomson  
 Head of Group Audit Latin America & Mexico  
 Tel (52) 55 5721 6236

----- Forwarded by Graham THOMSON/HBMX/HSBC on 22/03/2007 10:14 a.m. -----

Paul A THURSTON/HBMX/HSBC 21/03/2007 To: Graham THOMSON/HBMX/HSBC@HSBC  
 08:02 p.m.  
 cc:  
 Subject: Fw: [REDACTED]  
 ct:

Graham,

As promised.

Regards

Paul

----- Forwarded by Paul A THURSTON/HBMX/HSBC on 21/03/2007 07:45 p.m. -----

Leopoldo R BARROSO/HBMX/HSBC 20/03/2007 To: Paul A THURSTON/HBMX/HSBC@HSBC  
 10:15 p.m.  
 cc: Andrew PROSSER/HBMX/HSBC@HSBC,  
 david.leighton@hsbc.com.mx, Rafael Arana Garza@hsbc.com.mx,  
 Ramon GARCIA/HBMX/HSBC@HSBC, Sandy  
 Flockhart/HBMX/HSBC@HSBC  
 Subject: Re: Fw: [REDACTED]  
 ct:

Paul,

I am enclosing a draft of the aforementioned report in a document file; however, many of the events disclosed for executive purposes have not been quoted or included in their totality, thus a hard copy of the complete version with all necessary Annexes will be sent to your office, early tomorrow (9:00 AM).

Permanent Subcommittee on Investigations  
 EXHIBIT #14

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HSBC OCC 8874315

I would like to have the opportunity to address some of your questions, which are partially responded throughout the document.

- The customer was not a referral from other part of the Group, since the account was opened during [REDACTED] before HSBC actually acquired Bital.
- The Money Laundering deterrence reporting history is well documented in the report.
- This was a Corporate entity, and as such it should had been managed by other business segment in our opinion; however, this issue has been discussed at the MLD Committee, not only concerning this case, but others that had been brought to the attention of said Committee, but a definition has not been attained, since the nature of the Committee limits its capacity to exercise a migration of customers from one segment to another, though, it has been stated that our detection, and AML enforcement rules might be biased by having entities recorded and managed by wrong types of business lines.
- The search across the group has been initially requested with the companies, and individuals, directly associated to the case. As for the other entities that could be associated as beneficiaries, or issuing parties of remittances, or other financial transactions are pending response from the operating areas in order to be identified, since this information is not available at our main operating platform, this should be completed tomorrow, and the report would be also updated.

Should you need any explanation of the enclosed report, please call me at your earliest convenience.

Kind Regards

Leopoldo



Paul A THURSTON/HBMX/HSBC

Paul A THURSTON/HBMX/HSBC 20/03/2007  
11:39 a.m.

To: Leopoldo R BARROSO/HBMX/HSBC@HSBC  
cc: Sandy Flockhart, David Leighton, Rafael Arana Garza@hsbc.com.mx,  
Ramon GARCIA/HBMX/HSBC@HSBC, Andrew  
PROSSER/HBMX/HSBC@HSBC  
Subject: Fw: [REDACTED]  
cc:

Leopoldo,

David has forwarded your note to me this morning. This is a very serious, and high profile, case which has potential reputational damage to the HSBC Group, and must be given the highest priority.

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HSBC OCC 8874316



By now, I would hope that you will have completed your analysis of the case and I would ask that you let me have a report by the end of the day. I would like to know, inter alia, how this account was opened (was it a referral from another part of the Group or a local account opening?), the activity on the account, the money laundering reporting history (including the names of the people in PFS who claimed to have detailed knowledge of the customer and declined to make a report), and the current status of contact with the authorities on this case. As this is a corporate entity, I am surprised that PFS management appear to be managing the relationship, and perhaps you could also clarify this.

I trust that we have already initiated a trawl across the Group for any other accounts held by this company, the connected individuals, and associated companies and/or individuals (including those who have sent remittances to, or received them from, this account), and I would like to know what we have found from this, thus far.

I would presume that BSE would be helping in this investigation, and hence I am also copying Andrew Prosser.

Please get back to me on this by the end of the day.

Thanks

Paul

----- Forwarded by Paul A THURSTON/HBMX/HSBC on 20/03/2007 11:02 a.m. -----

Leopoldo R BARROSO/HBMX/HSBC 15-03-07  
10:50 AM

To: david.leighton@hsbc.com.mx  
cc: ramon.garcia@hsbc.com.mx  
Subject: [REDACTED]  
[REDACTED]

David,

As a consequence of an investigation initiated by the PGR (SIFDN) into [REDACTED]

This customer was reported to the authorities by ISBM during [REDACTED] (even which in our opinion triggered all this process), and several attempts were made to report them recently, and eventually cancel the relationship as prospected by MLD at the MLD Committee (these observations, and requires so the business are properly documented in the MLD Committee minutes); however, PFS argued that the customer was false, properly documented, and known by the business and that a cancellation was not accepted, nor a new report to the authorities was desirable. As such the business assumed the full responsibility of any deriving efforts as the one that unfortunately occurred yesterday.

I am breaking a more explicit and comprehensive note of our analysis of the case, and all of the events in a timeline that preceded this unfortunate act.

HSBC's name has not been printed yet in any media or press report, however, we might expect some more heat on this issue, though my

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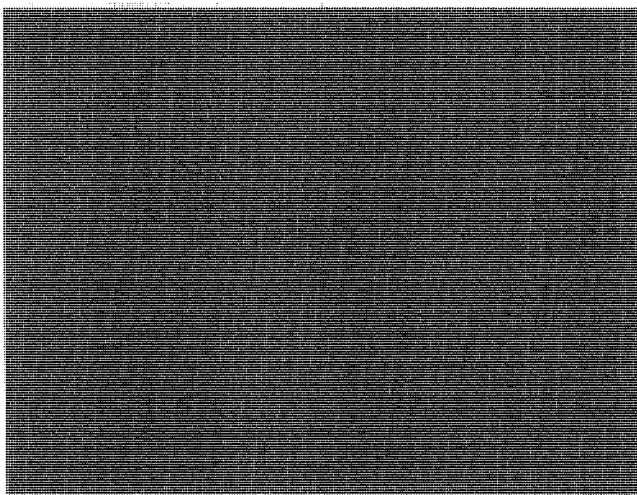
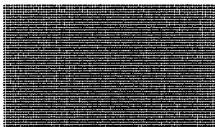
HSBC OCC 8874317

estimation is that we were not the only bank, they were operating with, since their balances with HSBC are not very high, specially when related to the amount of the seizure.

A copy of the official press release by the PCR in Spanish is attached to this Email, including pictures of the bill, and weapons seized.

Should you need me for an immediate debriefing, I am available at your earliest convenience.

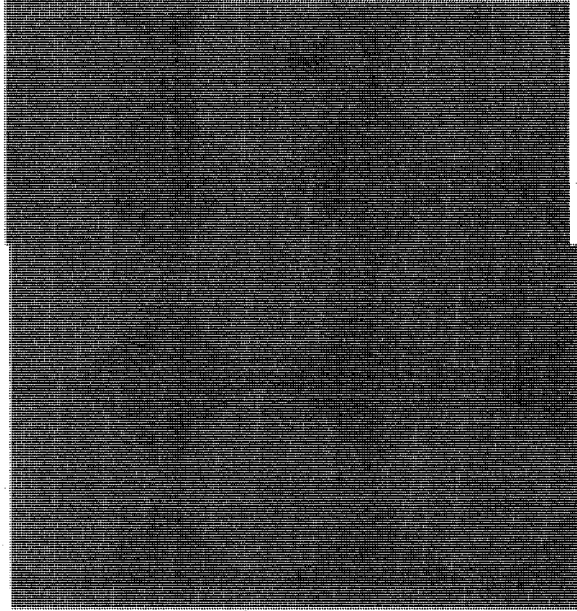
Regards,  
Leopoldo



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HSBC OCC 8874318



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Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.      HSBC OCC 8874319

Redacted Material  
Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.      HSBC OCC 8874326

From: Susan A WRIGHT  
 Sent: Mon Mar 26 17:33:37 2007  
 To: Graham THOMSON  
 Cc: David W J BAGLEY; John F ROOT; Warren G LEAMING  
 Subject: Fw: Travellers Cheques  
 Importance: Normal  
 Attachments: Doc Link.htm; HBMX CMP PLD 018.04 - AML Procedures on Traveller Cheques.doc;  
 HBMX CMP PLD 015.04 [REDACTED].doc

Graham,

Further to my note last week I have in fact located the note from Ramon re  
 [REDACTED] Attached for your info.

Regards Susan Wright

----- Forwarded by Susan A WRIGHT/HGHQ/HSBC on 26/03/2007 17:27 -----

Ramon GARCIA/HBMX/HSBC  
 HBMX  
 30/11/2004 00:52  
 Mail Size: 3147

To  
 John F ROOT/HGHQ/HSBC@HSBC  
 cc  
 Carlos ROCHIN/HBMX/HSBC@HSBC, David W J BAGLEY/HGHQ/HSBC@HSBC, Susan A  
 WRIGHT/HGHQ/HSBC@HSBC  
 Subject  
 Re: Travellers Cheques  
 Entity  
 HSBC Holdings plc - HGHQ

John,

Please find attached a preliminary note on traveller cheques.

More information is being compiled and will be delivered soon.

By the way, you might find interesting a recent case involving traveller  
 cheques, whose report is also attached.

Regards,

Ramon

Permanent Subcommittee on Investigations  
 EXHIBIT #15

Redacted Material  
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.A. HSBC OCC 8876645

John F ROOT  
08/11/2004 02:47 p.m.  
To: Ramon GARCIA/HBMX/HSBC@HSBC, Carlos ROCKIN/HBMX/HSBC@HSBC  
cc: David W J BAGLEY/HGHQ/HSBC@HSBC, Susan A WRIGHT/HGHQ/HSBC@HSBC  
Subject: Travellers Cheques

Ramon and Carlos,

I note that in the year through 3Q04, HBMX has sold over USD 110 million of travellers cheques, an amount that eclipses that of HBEU here in the UK, and that is several orders of magnitude higher than any other non-UK entity, including Hong Kong and the US. In fact, it represents one-third of the Group's total global traveller's cheque business (with the UK representing another third).

Could you kindly prepare a report for GHQ summarising the money laundering procedures currently in place for such a booming business. Please include in this report KYC controls, number of SARs in the YTD, breakdown by region and branch, etc., etc.

Thank you.

Kind regards,

John Root

<<>> <<>> <<>>

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 8876646

From: Sandy Flockhart  
 Sent: Wed Apr 04 15:13:37 2007  
 To: Graham THOMSON; Matthew J W KING  
 Cc: Liz A TESTER; Paul A THURSTON; Sergio PINA  
 Subject: Re: GROUP AUDIT COMMITTEE - APR07  
 Importance: Normal  
 Attachments: Doc Link.htm

Graham,

I believe you need to show some light and shade in the steps taken to improve documentation, the improvement in Fiduciario, the rationalisation of Fianzas, in Fianzas we know the issue but in Fiduciario as we cannot lay off the risk there will always be uncertainty the fact that in credit cards the principal issue is the updating of Fianzo and growth pains and balancing of resources, the fact that our principal fraud reflected in prior years and that the cajero frauds were organised crime events and that prevention was very difficult unless staff spoke up and possibly there was pressure put on them. As for regulatory fines we have stopped fighting these which may be a mistake but a number were where the past administration decided to clear their books.

This type of analysis should be brought in the Audit Cms attention. I would appreciate if you could consider such an analysis as it will benefit members understanding of our environment.

Regards

Sandy

----- Original Message -----

From: Graham THOMSON  
 Sent: 04/02/2007 05:46 PM  
 To: Matthew J W KING  
 Cc: Liz A TESTER; Paul A THURSTON; Sandy Flockhart; Sergio PINA  
 Subject: Re: GROUP AUDIT COMMITTEE - APR07

Matthew

In response to your email I comment as follows:

The main systemic weaknesses in HBMX, which I believe remain outstanding, are as follows:

KYC as identified in branch and continuous audit reports.

The lack of adequate documentation and filing systems which remain from the former Bital days, evidenced most sharply in the legal cases in Bonds and the outstanding Trust cases, where we continue to be at risk.

Lack of a compliance culture, evidenced (in the most serious way) by the number of staff defalcations and (in a more widespread general negligence) in

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the number of fines we receive from the regulators for avoidable errors -  
e.g. failing to report branch openings, or senior management appointments, on  
time.

User access control and passwords.

Inconsistent MI produced by Finance, the Business and CRM which has hindered  
early identification of problems as well as hampering effective decision  
making.

Regarding operating losses and credit card frauds I append the following  
comments:

Op Losses - The trend in 4Q06 caught the attention of Management and action  
is being taken to mitigate losses. A working group is being established to  
improve the reporting (timeliness and completeness), accuracy of the Gordon  
database and analysis of events, based on recommendations made recently by  
GAO.

Credit Cards - A review of credit card frauds which was the most significant  
contributor to Op Loss, was recently completed by GHQ and the business is  
responding to the report's recommendations and are putting in place a series  
of steps to improve the quality of our card fraud prevention and management  
so as to reduce card fraud back to within local industry norms.

The foregoing was discussed with Paul Thurston. These comments will be  
included in my report to the next HBMX Audit committee.

Regards

Graham Thomson  
Head of Group Audit Latin America & Mexico  
Tel (52) 55 5721 6236

Matthew J W KING/CGM INA GHQ/HGHQ/HSBC  
Sent by: Liz A TESTER  
02/04/2007 04:52 a.m.

To  
Graham THOMSON-HBMX/HSBC@HSBC  
cc

Subject  
Re: GROUP AUDIT COMMITTEE - APR07

My I please have a response to the attached today as I need to finalise my  
GAC papers first thing tomorrow.

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Regards,

Matthew King

Matthew J W KING/GGM INA GUQ-HGHQ@HSBC  
GGM INA GHQ-HGHQ  
Sent by: LIA A TESTER  
28/03/2007 13:19  
Phone No: 799 21176  
+44 (0) 79 799 21176  
Mail Size: 2495

To  
Graham THOMSON/HBMX/HSBC@HSBC  
cc

Subject:  
Re: GROUP AUDIT COMMITTEE - APR07  
Entity  
HSBC Holdings plc - HGHQ

Graham,

Thanks,

Could you summarise the main systemic weaknesses to HBMX which you believe remain outstanding. I appreciate these may already have been reported, but presumably some have been addressed. Where do we stand on the rising (I think) incidence of operating losses and credit card frauds?

Regards,

Matthew King

<<...>>

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HSBC OCC 8874330



From: Graham THOMSON  
 Sent: Fri Apr 20 19:43:28 2007  
 To: Matthew J W KING  
 Cc: David W J BAGLEY; Liz A TESTER; Sandy Flockhart; Paul A THURSTON;  
 Rafael Arana.Garza@hsbc.com.mx@HSBC; Ramon.GARCIA@hsbc.com.mx@HSBC;  
 philip.GRECKI@hsbc.com.mx@HSBC; Nick GILMOUR; Jose Manuel Dominguez  
 Subject: Re: Managerial Letter: HBMX - [REDACTED]  
 Importance: Normal  
 Attachments: Doc Link.htm

Manhew

I refer to your attached email, which was considered at yesterday's meeting of the [REDACTED] committee, chaired by Paul Thurston.

This meeting, the third chaired by Paul about [REDACTED] that involved GAQ, is part of the process he initiated over a month ago following the seizure of the arms and money from our customer's premises and his requests for separate reviews to be completed by CMP, PFS, PIF and GAQ. Reports from CMP and PFS had been considered at a previous meeting.

The meeting considered the recommendations detailed in GAQ's report. It received a verbal report from PIF (written interim report received post-meeting) on the results of its investigations to date into branch staff there were associated with the account. The investigations are still continuing.

Paul's summary of the meeting and its action points are detailed in the attached email. Other points are as follows:

1. The meeting acknowledged the difficulty in accurately completing KYC checks where customers deliberately tried to conceal the real intent of their business activities, as appears to have been the case with [REDACTED]
2. The meeting expressed reservations over the practicality of the new KYC requirements recently introduced by CNBV which required customers to project their transactional activity to allow individual benchmarks to be set that could be used to compare with actual activity.
3. PIF's investigations, which are continuing, confirmed that Alvaro Rocha had based his recommendation to the AML committee in AUG05 not to report [REDACTED] to the authorities, on incorrect representations made to him by staff, i.e. he had been lied to. PIF further confirmed that some of the KYC visits probably did not occur, that some of the staff involved had breached code of conduct requirements by making in some cases sizeable loans to each other although there was no indication at this time to suggest that any had benefited directly from the [REDACTED] connection.
4. [REDACTED] indicated that the branch staff involved in completing inaccurate visit reports should be dismissed. Any further disciplinary action should await the findings of the completed PIF investigation.
5. Ramon Garcia confirmed that other banks [REDACTED]

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involved as bankers with [REDACTED] and not reported the customer to the authorities, despite hosting apparently unusual transactions similar in nature to those recorded by HBMX. [REDACTED] he did not believe HBMX would receive a censure.

A follow up meeting will be held to monitor progress in implementing the action points.

With regard to your offer to send someone to review the AML alert process, the following is planned:

a. CEO HBMX will review the need for any additional support from GHQ with Group Compliance, once the immediate action steps have been completed; and  
b. GAQ has scheduled an audit for 3Q07 of this department as part of its 2007 annual plan. A focus of that audit will be on the re-engineered AML and CCC processes which will be implemented as a result of the above meeting. We shall also be strengthening our continuous and branch auditing focus on KYC although as you will recollect these weaknesses have been a repetitive theme of my comments to HBMX audit committee meetings.

Please let me know if you require any clarification on the foregoing, pending which summary comments will be tabled at LAM RAC, given that the case was discussed at yesterday's MAC meeting.

Regards

Graham Thomson  
Head of Group Audit Latin America & the Caribbean  
Tel (52) 55 5721 6236

----- Forwarded by Graham THOMSON/HBMX/HSBC on 20/04/2007 08:46 a.m. -----

Paul A THURSTON/HBMX/HSBC  
19/04/2007 09:03 a.m.

To  
Rafael Arana Garza/HBMX/HSBC@HSBC, Jose Manuel Dominguez/HBMX/HSBC@HSBC,  
Graham THOMSON/HBMX/HSBC@HSBC, Ramon GARCIA/HBMX/HSBC@HSBC, Leopoldo R  
BARROSO/HBMX/HSBC@HSBC, Nick GILMOUR/HBMX/HSBC@HSBC, Philip  
GRECK/HBMX/HSBC@HSBC

CC  
Sandy Flockhart/HBMX/HSBC@HSBC  
Subject  
[REDACTED]

Following our meeting yesterday, I am summarising the key action items that need to be progressed:

- The Audit report recommendations will be implemented as follows:

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1. The representation at CCC to be reviewed and proposed membership submitted to CNBV for approval. (Garcia)
2. Business Heads must remind their CCC representatives of the importance of their role and of taking an independent view. They must be prepared to challenge their colleagues if they are not satisfied with the responses they receive. [REDACTED]
3. The analysis, assessment and reporting procedures need to be revamped. The key is to have appropriate escalation procedures to ensure that higher risk cases are brought to senior management attention, and where the CCC or CMP has any concerns, these are to be brought to the attention of the Customer Group Heads immediately. (Garcia)
4. The management processes of the CCC must be strengthened. The minutes of meetings should identify clearly the decisions taken, and there need to be improved procedures to ensure that open items are always followed up at subsequent meetings. (Garcia)
5. PFS and CMB relationship managers should be given further training in the correct completion of KYC assessment reports. (Garcia, [REDACTED])
6. A review should be undertaken to identify all corporate entities that remain under management by PFS. these should be transferred to CMB without delay. [REDACTED]
7. Branch staff who completed false KYC reports should be dismissed, once the ongoing PIF investigation has been completed [REDACTED]

Please ensure that these items are followed up and provide a formal written response to me on the above points, confirming that these recommendations have been implemented by 18 May 2007.

- The detailed PIF review, which has been undertaken over the last 2 weeks will be completed, and a second interview will be arranged with one executive, and a report prepared, with recommendations for disciplinary action. [REDACTED]
- Although the PIF review has not found any evidence of direct linkage between the staff involved and the company (subject to the further interview to be arranged), it has surfaced evidence of breaches of policies in respect of intra-staff loans, and documentation signed in blank. [REDACTED] will prepare a CEO circular re-stating our policy and zero tolerance approach, and PFS/CMB Heads should personally reinforce this through their management teams. [REDACTED]
- The improvement of KYC procedures, account opening and file maintenance, which is currently comprised of a number of individual initiatives, needs to be brought into one coherent programme and given appropriate emphasis. The incoming COO HBMX will be tasked with reviewing these and putting an implementation plan in place.
- The review of other cases which have similar patterns, and all high risk cases, has been completed, and a special CCC meeting will be arranged within

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a week to review these cases. (Garcia/Barroso)

- The review of other pharmaceutical companies which have had money laundering alerts is underway but needs to be completed. (Garcia/Barroso)

- We continue to await the list of other names from the federal authorities which they will require us to check. (Barroso)

- Contact must be maintained with the authorities, with whom we will continue to co-operate fully, to maintain our reputation with them. (Garcia)

I will arrange a further meeting to review progress on the above.

Regards

Paul

Matthew J W KING/GGM INA GHQ/HGHQ/HSBC  
Sent by: Liz A TESTER  
18/04/2007 04:29 a.m.

To  
Graham THOMSON/HBMX/HSBC@HSBC  
cc  
David W J BAGLEY/HGHQ/HSBC@HSBC, Sandy Flockhart/HBMX/HSBC@HSBC  
Subject  
Re: Monetary Letter: HBMX - [REDACTED]

Graham,

Not a happy story. I note the recommendations will be discussed later today and no doubt subsequently. My initial reactions are set out below.

Please advise what action is taken in respect of [REDACTED] who appears to have vouched for this customer in AUG05, and then to have failed to fulfil his undertakings to the CCC Committee in DEC06. As a reasonably senior executive I would have expected a more committed approach to his responsibilities than appears from this saga.

The inconsistencies in the visit reports obviously raise some questions about whether staff were more closely involved with the customer than they should have been. How is this being addressed?

The fact that staff are producing reports that are unreliable is a serious issue in itself and needs to be taken into account in considering the appropriate disciplinary action.

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HSBC OCC 8875013

The weakness in the processes within MLD to analyse and monitor CAMP alerts, and to act as a check and balance on management, is obviously a general concern. Is it worth having someone come into look at processes from top to bottom (including at the CCC) to ensure they are robust?

Finally, are there any other customers where there is a similar fact pattern?

Regards,

Matthew King

<<>>

**HSBC Bank USA, National Association**

**Office Memorandum**

TO: Denise Reilly

FROM: Judy Stoldt  
Gloria Strazza

DATE: May 1, 2007

RE: Wall Street Journal Article Regarding Wachovia

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This memorandum summarizes an article in the April 26, 2008 edition of the Wall Street Journal (WSJ) that discussed an investigation into Wachovia's casas de cambio business.

This memorandum also discusses the actions that HBUS has taken with respect to the casas de cambio mentioned in the article as well as other cambios that were not mentioned in the article.

Please note that HBUS does not hold any account for any casa de cambio mentioned in the WSJ article. The only HBUS connection to activity involving those named casas de cambio is activity that was conducted through our correspondent accounts, and most notably through our account with HSBC Bank Mexico (HBMX).

**1. Wall Street Journal Article**

**Summary of Article:**

- Federal prosecutors are investigating Wachovia as part of a probe of alleged laundering of drug proceeds by Mexican and Colombian money-transfer companies. Wachovia is allegedly one of "several large US banks" that have come under scrutiny for relationships with such companies. (The other "large US banks" were not named by the WSJ.) Wachovia built ties to casas de cambio in order to tap the Hispanic market. Wachovia held deposits for the foreign-exchange houses and provided back-office services to those entities. Wachovia is cooperating with investigators and, in December and January, severed relationships with Mexican foreign-exchange firms.
- Four casas de cambio were mentioned in the Journal article - two that are associated with Wachovia (Casa de Cambio Puebla and Majapara Casa de Cambio) and two that were mentioned in a sidebar (Sigue Corp. and Ribadeo Casa de Cambio. Sigue was fined by the Justice Department and Ribadeo laundered funds indirectly via Union Bank of California. The allegations involving Union Bank and Ribadeo resulted in an enforcement action against Union Bank.)

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These cambios are discussed below, along with investigations HBUS performed into these entities (both as a result of the Journal article and prior to the article) and other cambios.

## 2. WSJ List of Casas de Cambios:

- Casa de Cambio Puebla – Per the WSJ, Puebla is a Mexican chain of cambios and is subject to a federal court action in Miami, Florida in which federal agents seized more than \$11 million in 23 Wachovia accounts belonging to this entity. Prosecutors allege the money was “being laundered”.
- Activity: No accounts are held by HBUS; a former Banknotes account was closed in June 2007; funds involving this entity passed through correspondent accounts held by HBUS. (Reference comments below).
  - On June 15, 2007, HBUS [REDACTED] learned (through HBMX) of a seizure warrant issued by the Southern District of Florida at the request of the Drug Enforcement Administration seeking to freeze \$11 million in 23 accounts at Wachovia. All banknote activity at HBUS was terminated in June 2007 as a result of the seizure warrant issued against Wachovia. In October 2007, at the suggestion of the OCC to perform a money service business review, HBUS commenced a review of wire activity over a 12 month period (October 2006 to September 2007) in the dollar range of \$5,000 to \$25,000. (This review will be referred to as the “October 2007 Review”).
  - On November 8, 2007, a news article was published in the Miami Herald that alleged that drug funds were being laundered through Puebla. Upon receipt of the article, HBUS confirmed that it had no account relationship with Puebla.
  - The October 2007 Review revealed that wires involving Puebla had passed through its correspondent accounts. On November 30, 2007, HBUS [REDACTED] reporting that approximately 650 wire transactions had cleared through the HBMX correspondent account where Puebla was either the originator or beneficiary of the wire from January 1 through October 31, 2007. On November 16, 2007, HBUS added the name “Casa de Cambio Puebla” to its Internal Watch List to ensure that no accounts could be opened for this entity. On January 23, 2008, HBUS added the name “Casa da Cambio Puebla” to its internal wire filter system. The internal wire filter causes all wire transactions that are attempted to be processed through HBUS to be scanned against the names in the “filter”. The filter will stop any wire that includes a “filtered” name (in this case “Casa da Cambio Puebla”). An HBUS wire room employee would then reject the payment.
  - HBMX, which held an account for Puebla, “froze” its account after the November news article was published. HBMX provided HBUS with a list of 91 parties presumed to be related to Puebla. Eighty-one (81) parties were HBMX customers, whose accounts were frozen by HBMX. A wire search was performed (for the period January 1 through October 31, 2007) on these 91 names that resulted in 523 potential transactions. After review, 170 wire transactions totaling \$7,370,508 were found to have been conducted by 6 individuals or entities whose names exactly matched names on the list of 91. [REDACTED] (It is noted that all of these wires originated by individuals and entities from accounts held at Wachovia. A search revealed that none had accounts at HBUS.)
  - In February 2008, HBUS conducted a follow-up analysis of the cambios identified by HBUS in its October 2007 Review that were deemed to require follow-up review. The February 2008 review examined wires processed between October 2007 and December 2007 in amounts ranging from \$5,000 to \$25,000, and it was revealed that only 3 transactions were processed through HBUS correspondent accounts.

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- **Sigue Corp.** – A money service business that allegedly processed \$24.7 million in suspicious money remittances related to drug-trafficking proceeds. It forfeited \$15 million and agreed to spend \$9.7 million to upgrade its anti-money laundering program as part of a deferred prosecution agreement reached with the Department of Justice.
  - Activity: No account relationship is held with this entity; funds involving this entity passed through correspondent accounts held at HBUS. (Reference comments below.)
  - On January 12, 2008, HBUS noted a news article that reported Sigue Corp., a California money service business (MSB), was entering into a record \$25 million settlement with the Justice Department for money laundering violations related to the manner in which it handled remittances to Latin America. The penalty assessed against Sigue set a record for a settlement with the Justice Department by a money service business. The allegations focused on anti-money laundering deficiencies that permitted arguably suspicious transactions to occur primarily between customers in the US in the Dominican Republic and Mexico.
  - Based on the article, HBUS conducted a review of its accounts (which confirmed that no relationships were held with Sigue), an independent investigation into Sigue and a review of wire transfer activity.
  - The independent investigative search on Sigue and its founder (Guillermo de la Vina) was conducted to determine whether either were the subject of any other negative news or law enforcement activity. That investigation revealed that a Sigue employee was indicted for assisting drug traffickers to launder drug proceeds but Sigue itself was not indicted. Sigue was mentioned in another article as having allowed \$295,000 to be transferred from an account at Arvest Bank to an illegal alien in Mexico. (These allegations arose out of an

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Immigration and Customs Enforcement action against the illegal alien's employer. Sigue, again, was not implicated.)

- o The wire review revealed 161 transactions for \$492.5 million were sent over a 12 month period (January 1 through December 31, 2007). HBUS contacted HBMX (the beneficiary bank) for information about its customer and these wire transactions. HBMX stated that its relationship with Sigue is conducted within certain internal parameters (such as limiting Sigue to conducting transactions for individual customers to \$2,000 USD per transaction).
- o [REDACTED] Sigue had, between January 1 and December 31, 2007, sent 159 wire transfers totaling \$484,499,916 to its own account at HBMX.

[REDACTED] Sigue was not added to the wire filter as Sigue entered into a written agreement with the Department of Justice to enhance its AML program and was not (per the investigative search) the subject of any other money laundering investigations.

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#### 3. Enforcement Actions Mentioned in WSJ Article:

- As mentioned, the WSJ article's side-bar discussed 3 enforcement actions against financial institutions as follows:
  - o Union Bank of California – Alleged to have allowed a casa de cambio to launder drug funds through its accounts  
[REDACTED]
  - o American Express International Bank – allegedly failed to report \$55 million laundered through accounts owned by drug traffickers
  - o Bank Atlantic – Undercover agents found that drug funds were laundered through one branch.
- HBUS originally reviewed these enforcement actions to uncover any names of drug traffickers or casas de cambio, but reviewed them again in light of the WSJ article. No other names could be associated with these enforcement actions (other than Ribardo). [REDACTED]

**EXCERPT FROM SIGUE CORPORATION  
DEFERRED PROSECUTION AGREEMENT  
JANUARY 24, 2008**

**FACTUAL STATEMENT**

1. Sigue Corporation, organized under the laws of Delaware, and its affiliated operating company, Sigue, LLC, organized under the laws of Nevada, are licensed money service businesses headquartered in San Fernando, California (hereinafter jointly referred to as "Sigue"). Sigue's primary business activity is the transmission of funds from the United States to Mexico and Latin America. Sigue operates by and through a network of more than 7,500 "authorized delegates" throughout the United States. Authorized delegates are typically small "mom and pop" type businesses that have been contracted to offer Sigue's money transmission services. The authorized delegates and Sigue each earn a small fee for the transactions conducted through the authorized delegates. At the Federal level, Sigue is regulated by the Financial Crimes Enforcement Network ("FinCEN") and the Internal Revenue Service.

2. The U.S. Department of Justice, Criminal Division, Asset Forfeiture and Money Laundering Section ("AFMLS"), the U.S. Drug Enforcement Administration ("DEA") and the Internal Revenue Service ("IRS"), have determined that from November 2003 through March 2005, Sigue violated provisions of the Bank Secrecy Act which require financial institutions to maintain anti-money laundering compliance programs. The violations at Sigue were serious and systemic, and allowed tens of millions of dollars of suspicious financial transactions to be conducted through Sigue, including transactions involving funds represented by undercover U.S. law enforcement agents to be drug proceeds.

**OPERATION HIGH WIRE**

3. From November 24, 2003 through March 30, 2005, Sigue authorized delegates knowingly accepted and transmitted more than \$500,000 of money represented by undercover U.S. law enforcement officers to be proceeds of drug trafficking. The money used in the undercover operations was received by and wired through fifty-nine (59) separate Sigue authorized delegates in twenty-two (22) states.

4. During each operation, undercover agents posed as drug traffickers and approached Sigue authorized delegates in the United States and asked for assistance in sending money to one of seven undercover Mexican law enforcement officers located in Mexico City, Mexico. The undercover agents clearly stated to the authorized delegates that the currency they

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wanted to send through the delegates was proceeds of drug trafficking and was being sent as payment to the "source of supply." The undercover agents informed the authorized delegates that they did not want law enforcement to learn of the transactions, and that they preferred not to provide any form of identification or address information. When Sique authorized delegates requested some form of identification from the undercover agents, the agents produced multiple forms of identification cards, all in different names and bearing obviously different likenesses. The following is a summary of one of the operations, which closely mirrors each of the successful operations:

On January 10, 2005, a DEA Special Agent, acting in an undercover capacity using an assumed identity, entered the targeted Sique authorized delegate's store and approached a male clerk behind the counter. The Special Agent asked the clerk how much money he could send to the Federal District in Mexico without showing identification. The clerk responded that he thought the Special Agent could send \$700 without identification, but he was not sure. The clerk suggested that the Special Agent use the phone to call Sique corporate headquarters. The Special Agent told the clerk that he did not want the police or government to find out about the transaction because he had made the money selling marijuana. The clerk told the Special Agent not to worry about it. The Special Agent asked if he could give any name when he conducted the transaction. The clerk told him that it only mattered that the person receiving the money knew which name the Special Agent used when he sent the money so that the receiver could pick up the money. The Special Agent asked if the store would tell the government; the clerk again told the Special Agent not to worry about it. The Special Agent conducted the transaction for \$900 and then asked the clerk if he could send \$10,000 by dividing it into smaller amounts. The clerk told the Special Agent that he could do so at that location, but that he might need to show identification at other locations. The Special Agent asked the clerk if he could send multiple transfers of under \$1,000 in one day. The clerk suggested that if the Special Agent used different names, he could send all the money in one day. The Special Agent told the clerk that he might be back, and the Special Agent left the store.

Two days later, the Special Agent returned to the store and told the same clerk that he wanted to send \$11,000. The Special Agent asked the clerk if he should do it by sending various transfers of \$950 using different names. The clerk agreed and stated that he didn't believe the other clerk in the store would mind. The Special Agent began conducting the transactions for \$950 each. After the second transaction, the clerk expressed concern that if the Special Agent was going to keep sending money from one location to the same person in Mexico that the transactions would be questioned. The clerk said he did not want to get in trouble for what he thought might be money laundering. He suggested that the Special Agent send the money to different people using different names.

The Special Agent conducted another transaction for \$950. The clerk told the Special Agent that so long as the Sique corporate operator was allowing the Special Agent to conduct the transactions, the Special Agent could continue to send money. The Special Agent again expressed concern that the clerk might contact the police, but the clerk assured him that he would not. The Special Agent mentioned again that he was in the marijuana business and that he did not want the government to find out. The clerk agreed. The Special Agent conducted five more transactions, sending \$950 each to different receivers in Mexico using different sender names. The clerk signed off on all the transactions and faxed the receipts to Sique corporate headquarters. During the last transaction, the clerk informed the Special Agent that it would have to be the last transaction because further transactions would cause problems. After that transaction, the Special Agent left the store.

5. In total, undercover agents conducted 84 successful transactions at 59 different locations (24 Sique authorized delegates properly refused to conduct such transactions). At 47 locations, the undercover agents, with the assistance of the authorized delegates, structured the cash transactions by splitting large cash amounts over \$10,000 into several smaller amounts to avoid triggering currency transaction reporting thresholds at the Sique corporate level. In some instances, the undercover agents asked Sique operators how much money could be sent without providing identification and the undercover agents stated that they did not have certain identifying information such as an address or telephone number. Each of the undercover transactions were recorded and/or videotaped by surveillance.

6. None of the authorized delegates reported the transactions to law enforcement, as required by the Bank Secrecy Act. At the corporate level, Sique identified and reported the structured transactions that the agents conducted, but failed to detect and report the broader money laundering scheme and take action to prevent the activity from recurring.

#### MONEY LAUNDERING VIOLATIONS BY SIQUE AND ITS AUTHORIZED DELEGATES

7. The 59 Sique authorized delegates who knowingly accepted and transmitted the money represented by the undercover law enforcement agents to be drug proceeds could be held individually liable for violations of the money laundering laws of the United States. Title 18, United States Code, Section 1956(a)(3) provides severe penalties (up to 20 years incarceration and a \$500,000 fine, or twice the value of the property involved in the transaction, whichever is greater) for whoever, conducts or attempts to conduct a financial transaction involving property

represented to be the proceeds of specified unlawful activity (which includes proceeds of drug trafficking), with the intent to (i) promote the carrying on of a specified unlawful activity; (ii) to conceal or disguise the nature, location, source, ownership, or control of property believed to be the proceeds of specified unlawful activity; or (iii) to avoid a transaction reporting requirement under State or Federal law.

8. In addition to the authorized delegates, the government maintains that Sique could also be held criminally liable for the illegal acts of their authorized delegates. A corporation is deemed to act through its officers, employees and agents, and their conduct will be imputed to the corporation so long as the officers, employees and agents were acting within the scope of their authority and their conduct is beneficial to the corporation. A corporation can be criminally liable for the conduct of any employee regardless of the employee's status or position within the corporation; even the lowest ranking employee may bind the corporation by his acts if they are committed within the scope of employment. Although a corporation is a legal entity and cannot be incarcerated, a financial institution convicted of money laundering violations would incur severe financial penalties and could ultimately lose its licenses to function as a financial institution.

#### **ANTI-MONEY LAUNDERING COMPLIANCE REQUIREMENTS FOR MSBs**

9. Congress enacted the Bank Secrecy Act ("BSA"), 31 U.S.C. § 5311 et seq., and its implementing regulations to address an increase in criminal money laundering activities utilizing financial institutions. Among other provisions, the BSA requires financial institutions to maintain programs designed to detect and report suspicious activity that might be indicative of money laundering, terrorist financing and other financial crimes, and to maintain certain records and file reports related thereto that are especially useful in criminal, tax or regulatory investigations or proceedings. Fundamental laws establishing anti-money laundering obligations of financial institutions in the United States include the BSA; the Money Laundering Control Act of 1986 (codified in relevant part at 18 U.S.C. §§ 1956 and 1957); and the USA PATRIOT Act of 2001, which significantly amended both laws and extended an anti-money laundering program requirement beyond federally insured deposit institutions to all types of financial institutions.

10. Pursuant to Title 31, United States Code, Section 5318(h)(1) and 12 C.F.R. § 563.177(c), financial institutions are required to establish and maintain an anti-money laundering ("AML") compliance program that, at a minimum: (a) provides internal policies, procedures, and controls designed to guard against money laundering; (b) provides for an individual or individuals to coordinate and monitor day-to-day compliance with the BSA and AML requirements; (c) provides for an ongoing employee training program; and (d) provides for independent testing for compliance.

11. Pursuant to 31 C.F.R. § 103.125(a), money service businesses (MSBs) are required to develop, implement, and maintain an effective anti-money laundering program reasonably designed to prevent the business from being used to facilitate money laundering. The program must be commensurate with the risks posed by the location, size, nature, and volume of the financial services provided by the MSB. Additionally, the program must incorporate policies, procedures, and controls reasonably designed to assure compliance with the BSA and implementing regulations. With respect to MSBs that utilize foreign agents or counter parties, the anti-money laundering program must include risk-based policies, procedures, and controls designed to identify and minimize money laundering risks associated with foreign agents and counter parties that facilitate the flow of funds into and out of the United States. The program must be aimed at preventing the products and services of the business from being used to facilitate money laundering through these relationships and detecting the use of these products and services for money laundering or terrorist financing by the business or its agents.

12. The BSA specifically requires financial institutions to file with the Department of Treasury and, in some cases, appropriate Federal law enforcement agencies, a Suspicious Activity Report ("SAR"), in accordance with the form's instructions, when the type of activity described above is detected. See, 31 U.S.C. § 5318(g), 31 C.F.R. § 103.20. According to the form's instructions, Sigue was required to file a SAR with FinCEN, reporting any transaction conducted or attempted by, at, or through the money transmitter, if it involved or aggregated at least \$2,000 in funds, and Sigue knew, suspected, or had reason to suspect that:

- (i) The transaction involved funds derived from illegal activities or was intended or conducted in order to hide or disguise funds or assets derived from

illegal activities (including, without limitation, the ownership, nature, source, location, or control of such funds or assets) as part of a plan to violate or evade any federal law or regulation or to avoid any transaction reporting requirement under federal law or regulation.

- (ii) The transaction was designed to evade any requirements promulgated under the Bank Secrecy Act.
- (iii) The transaction has no business or apparent lawful purpose, and the money service business knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction.

**AML / BSA COMPLIANCE VIOLATIONS BY SIGUE AND ITS AUTHORIZED DELEGATES**

13. Sigue filed SAR's on the obviously structured undercover transactions, an indication that its AML systems are functional in at least one key aspect. At the same time, it failed to adequately investigate the structuring activity further and consequently failed to identify, report and prevent the broader pattern of money laundering and to file supplemental SARs. Sigue took no action to block such transactions from continuing to occur (the undercover operation lasted more than 1 year).

14. The investigation into this matter has determined that the primary cause of Sigue's failure to identify, report and prevent the money laundering activity is that, during the time period of November 2003 through March 2005, Sigue's AML program contained serious and systemic deficiencies in critical areas, including:

- (i) Inadequate supervision and control of authorized delegates;
- (ii) Failure to effectively monitor and investigate high-risk transactions;
- (iii) Failure to establish an effective risk-based AML program;
- (iv) Failure to exercise sufficient enhanced due diligence for high-risk transactions and customers;<sup>1</sup>

<sup>1</sup> For purposes of this Agreement and Factual Statement, the term "customer" includes any individual who conducts one or more transactions through the MSB as a sender or beneficiary, notwithstanding the lack of an ongoing relationship between the person and the MSB.

- (v) Failure to have an effective, on-going training program for authorized delegates;
- (vi) Failure to take appropriate action on customers and transactions deemed suspicious; and
- (vii) Failure to establish an effective independent review process to test the effectiveness of the AML program.

Some of the key AML and BSA deficiencies of law enforcement concerns were as follows:

Inadequate Supervision and Control of Authorized Delegates

15. Sigue assigns each authorized delegate a risk level, either low, medium, or high, depending on their operating location. High-risk areas generally corresponded with each of the areas designated by law enforcement as High Intensity Financial Crimes Areas (HIFCAs). Based on this classification system, Sigue theoretically would subject the transactions from the high-risk authorized delegates to an enhanced level of scrutiny to determine whether they are suspicious, and would file SARs as appropriate. This investigation found no evidence that Sigue implemented an effective risk-based supervision program for high-risk agents during the time period under review.

16. Sigue conducted only limited independent testing of authorized delegates and was consequently unable to identify widespread and systemic deficiencies in its monitoring and training programs. Between February 24, 2004 and February 26, 2004, Sigue contracted with a private firm to conduct compliance checks, but only at nine separate Sigue authorized delegate locations in California. Even with these, the contract investigator identified himself to the authorized delegate as an investigator acting on behalf of Sigue and asked each individual authorized delegate the same seven questions, as follows:

- a. What information are you supposed to collect from a customer who sends a \$4,000 wire?



- b. What would you do if a customer comes in four times a day and sends \$2,500 each time?
- c. What would you do if a customer comes in with someone else and you see them splitting up the money so that each of them sends a wire to the same beneficiary?
- d. What would you do if a customer who you thought had a low income sends about \$5,000?
- e. What do you think the risks are if you, the agent, were aware that a customer had money from drug sales and that the same customer was sending the money through you at the agent location?
- f. Do you think you have enough training in anti-money laundering?
- g. What would you do if a customer placed several wires on the same day under \$3,000?

17. Not surprisingly, the authorized delegates who were tested in this manner answered almost all of the questions correctly. Consistently, during the undercover operations, Sigue authorized delegates demonstrated a keen knowledge, not only of Sigue's policies and procedures, but also the money laundering laws of both the United States and Mexico. Yet, law enforcement conducted an historical analysis of the transactions accomplished at those authorized delegate locations and identified widespread and pervasive violations of Sigue's policies and procedures, particularly structuring activities that continued for months, sometimes years. In most of those cases, Sigue filed SARs on the transactions to report the structuring activity, but did not subject those transactions, customers, or authorized delegates to a sufficiently enhanced level of review.

18. Late in 2003, Sigue also began requiring authorized delegates to sign a document, dated November 19, 2003, entitled "Anti-Money Laundering Program," acknowledging receipt of the "Anti-Money Laundering Guide for Money Transmittal Agents of Sigue Corporation." The letter explained that it was the responsibility of the authorized delegate to appropriately

train each of its employees involved with the money transmittal business on Anti-Money Laundering laws and compliance efforts. This form was printed in both English and Spanish on the same document. In practice, the undercover agents routinely found copies of the money laundering guidelines, but in an unused condition, frequently still in the original packaging and unopened. Although Sigue had a training program for its authorized delegates, many of the authorized delegates or their employees subsequently interviewed said that they had received no training or materials on anti-money laundering.

#### Transaction Monitoring Deficiencies

19. At the corporate level, Sigue began implementing in 2001 and 2002 a proprietary automated transaction monitoring program that screened financial transactions for numerous categories of suspicious activities based on pre-identified "red flags." The monitoring system dramatically improved the company's ability to identify suspicious transactions and to file SARs with FinCEN.<sup>2</sup> The ultimate failure of the company was less in the design of the monitoring system, but more on the company's failure to adequately investigate flagged transactions further and its failure to take further action against the suspicious activities identified (such as notifying law enforcement directly or banning individuals from sending or receiving money from Sigue).

20. The company's reporting on suspicious transactions that it failed to adequately investigate is evidenced by its filing of SARs on almost all of the undercover transactions to report the obvious structuring, while failing to identify and report the broader money laundering activity. To determine whether the company's failure to identify and report the undercover money laundering activity was an isolated example or whether it was the result of systemic weaknesses within the corporation, investigators analyzed more than \$6.07 billion of transactions to determine whether similar cash structuring was prevalent. The result was the identification of more than \$47 million of structured transactions (including the undercover sting transactions) that Sigue identified and reported in SARs, but failed to take action to prevent from recurring.

21. To identify the most serious structuring examples, investigators sorted the transactions to select only those cases where one person sent or received more than \$50,000 in a

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<sup>2</sup> In 2001, Sigue filed only 52 SARs, but in 2002 it filed 1,072, and in 2003 it filed 1,663.

12-month time period through more than one transaction. Sigue claims that more than 90 percent of its transactions are from customers who send approximately \$300 twice a month to friends and family members in Mexico (\$7,200 annually). Accordingly, investigators reasoned that any person sending or receiving more than \$50,000 during a 12-month period would fall outside of the norms associated with Sigue's unique customer base and would be relatively easy for Sigue to detect, identify, report and prevent.

22. The result was the identification of 238 case examples of serious structuring schemes, cumulatively valued at \$25.4 million. The least significant of these examples is an individual who transferred, in a 12-month period, \$50,640 through 46 transactions, each transaction averaging \$1,100. One of the most blatant examples is an individual who transferred, in a 12-month period, \$324,091 to 15 different individuals in Mexico, through 370 transactions, each averaging \$875, using only two authorized delegate locations. Another individual transferred \$224,232 in 80 separate transactions on a 10-month period, with each transaction just under Sigue's reporting threshold of \$3,000. Within these case examples, there were occasional instances of structuring, which Sigue adequately reported, but Sigue failed to identify and report the broader money laundering schemes undertaken by these individuals.

#### Failure to Establish a Risk-Based AML Program

23. Sigue's primary business activity and operating location presents a high-risk of money laundering. Yet no financial institution of substantial size can possibly monitor every single transaction and customer, particularly, in Sigue's case, where the transactions and customers originate from authorized delegates who are far removed from Sigue's corporate operations. To remedy this, MSBs should conduct a formal and detailed risk assessment of each of its products, transactions, services, geographic locations, etc., and then concentrate their AML and BSA resources to specifically monitor and control those areas identified as the highest risk.

24. Sigue conducted a limited risk assessment of its operations and products, but it failed to implement an effective AML program designed to subject its highest risk areas to enhanced monitoring, supervision and control at three critical risk areas: the authorized delegates, the transactions, and the customers.

25. At the authorized delegate level, Sigue identified some authorized delegates as "high risk," yet very little was done to subject those high-risk delegates to any more monitoring, supervision or training than those authorized delegates classified as "low risk." Sigue failed to establish expected transaction parameters and limits for each authorized delegate, and failed to implement a program to subject high-risk delegates to enhanced monitoring for suspicious activity.

26. At the transaction level, Sigue implemented an automated monitoring system that was somewhat effective in identifying "red flags" of suspicious activity. This proprietary monitoring system was most effective in identifying instances of currency structuring. Yet Sigue's process did not include sufficient substantive review of the underlying activity. Sigue conducted some review of transactions associated with the same sender, but no review of transactions for the benefit of a single beneficiary. This failure was exacerbated by Sigue's failure to sufficiently review transactions from related senders or beneficiaries. Consequently, Sigue failed to identify and prohibit the transactions, authorized delegates, and "customers" involved in the undercover operation, which used dozens of different people spread across 22 different states to send structured drug money to a group of seven individuals in Mexico City. Had Sigue implemented a more robust investigative procedure, Sigue could have detected the undercover activity and taken action to report and prevent it.

27. At the customer level, Sigue failed to establish an effective risk-based Know Your Customer (KYC) program. Of course, as an MSB, Sigue operates substantially differently from traditional financial institutions, such as banks. Sigue does not require customers to open "accounts;" there is no application required to use Sigue services; and Sigue does not collect source of wealth information, verify employment, etc. Yet, to avoid potential violations of the money laundering laws of the United States, and the misuse of MSBs by money launderers, Sigue needs to implement enhanced due diligence procedures to collect appropriate information, at least from its highest risk customers and operating locations, so that it may reasonably identify, prevent, and report money laundering activities, as required by the BSA.

28. The traditional Sigue customer sends less than \$400 to Mexico several times a month. For these customers, there is very little KYC information that Sigue is required to

collect, under the BSA or the money laundering laws. Yet Sigue, as with all financial institutions, is required to have a SAR program. It is virtually impossible to have an effective SAR program unless the institution also has a KYC program. For MSBs the extent of the KYC information collected should necessarily, and as a practical matter, be risk-based. Sigue should be expected to have very little KYC information for a customer who uses its services to send \$400 twice a month to Mexico. However, Sigue and other MSBs should have enhanced due diligence procedures that require them to obtain additional information on customers who do a higher volume of recurrent transactions in significant sums, such as a customer who sends or receives more than \$25,000 during any 12 month period. Since these latter customers comprise a small percentage of Sigue's overall customer base (less than 3 percent), Sigue's KYC burden is not overwhelming or unreasonable for these customers. The BSA is intended in almost all respects to help financial institutions comply with the money laundering laws. In order to avoid misuse by money launderers, MSBs may need to implement enhanced AML policies and procedures to fully comply with the money laundering laws and the BSA.

#### SIGUE'S REMEDIAL ACTIONS AND COOPERATION

29. Even before learning of this investigation, Sigue had devoted considerable resources to correct and improve the identified BSA and AML deficiencies, agreed to terminate the licenses of the culpable authorized delegates, and implemented procedures to identify, report, and ultimately, block a broader range of suspicious transactions and customers, including the types of transactions identified during the law enforcement operation. As part of that effort, Sigue has:

- made significant investments in developing and implementing its current compliance program and internal controls;
- retained a knowledgeable and experienced staff, with extensive experience in the MSB industry, to oversee its compliance program;
- increased the total number of compliance personnel on staff to ensure adequate personnel are designated for executing the tactical objectives of the compliance program;

- purchased, developed and implemented advanced anti-money laundering systems and software to detect the misuse of Sigue's financial services;
- instituted an authorized delegate risk management department which is responsible for evaluating authorized delegates prior to contract approval;
- implemented policies requiring all authorized delegates to have undergone Bank Secrecy Act training, and developed authorized delegate-specific Bank Secrecy Act/Anti-Money Laundering Compliance Programs required for each prior to activation;
- deployed a significant team of compliance field personnel responsible for auditing authorized delegates' compliance with their Bank Secrecy Act/Anti-Money Laundering Compliance Programs and recommending disciplinary action, up to and including termination, for non-compliant authorized delegate;
- implemented a comprehensive, enterprise-wide employee training program in which all employees receive Bank Secrecy Act/Anti-Money Laundering training at least twice annually;
- retained a competent risk management consulting firm to perform an annual, independent review of the integrity and effectiveness of Sigue's compliance program and related internal controls.

#### **SIGUE'S CONTINUING REMEDIAL EFFORTS**

30. Sigue has cooperated and continues to cooperate with law enforcement and its regulators. Through organizational and program changes, Sigue has shown a commitment to compliance improvements and a dedication to effectively complying with its BSA and AML responsibilities. As part of its continuing efforts to implement an enhanced BSA and AML compliance program, Sigue has committed to the following remedial measures as part of the Deferred Prosecution Agreement:

A. Integrity of Compliance Program and Board Oversight

Sigue will continue to employ a specific individual within its high-level personnel as the Global Compliance Officer who is assigned overall responsibility for the BSA/AML compliance programs. The Global Compliance Officer will be qualified in AML compliance programs, will be delegated day-to-day operational responsibility for compliance, and will report directly to the Audit and Finance Committee of Sigue's Board of Directors. The Global Compliance Officer will be given adequate resources, authority, and direct access to the Board of Directors, and will report on an annual basis to the Board of Directors regarding the integrity and effectiveness of the compliance program.

B. Authorized Delegate Due Diligence

The Authorized Delegate approval process will be assigned to a department which engages in risk management and is independent from the sales and marketing function. Credit and criminal background checks will be run on all owners of Authorized Delegate applicants who own or control at least ten percent (10%) of the Authorized Delegate. Authorized Delegates will also be subject to periodic credit and criminal checks, under appropriate circumstances.

C. Monitoring

Sigue will implement and maintain a transaction monitoring system for the purpose of performing risk-based trend analysis related to sender, beneficiary, originating Authorized Delegate, and paying location transactional activity. The monitoring system will be effected in part through an enhanced identification requirement for senders whose transactions aggregate to \$2,000 or more in one day. Sigue will obtain sender's full name and address when sending any transfer (if the sender does not have an address, "none" or a code will be inserted in the appropriate fields) and will conduct an enhanced due diligence review of senders and beneficiaries, and all related persons, transmitting or receiving aggregate amounts more than \$25,000 during any 12-month period. Sigue will obtain beneficiary identification information for beneficiaries who receive remittances through Sigue's Mexico-based Authorized Delegates in amounts of \$950 or more in a single day and aggregate amounts greater than \$2,950 over a rolling five (5) day period.

D. Blocking

Signe will implement a transaction interdiction system for the purpose of enhancing the functionality of blocking remitters and beneficiaries of money transmittals, as appropriate, including the implementation of enhanced due diligence review procedures to determine whether senders and beneficiaries should be blocked from conducting further transactions where Signe has filed two or more Suspicious Activity Reports ("SARs") on the senders and/or beneficiaries, or related senders and/or beneficiaries, during any twelve-month period.

E. OFAC

Signe will implement an OFAC interdiction system that provides for real-time screening of remitters and beneficiaries of money transmittals. Signe will also periodically screen employees and Authorized Delegates against the OFAC lists.

F. Authorized Delegate Training and BSA/AML Compliance Program Reviews

Signe will provide BSA/AML training to all new Authorized Delegates before they are activated, and thereafter risk-based BSA/AML training. Signe will also implement a risk-based Authorized Delegate compliance review program, using dedicated compliance resources.



From: David W J BAGLEY  
 Sent: Wed Jul 18 16:52:54 2007  
 To: Warren G LEAMING  
 Subject: Fw: Weekly Compliance Report 02JUL-06JUL07  
 Importance: Normal

----- Forwarded by David W J BAGLEY/HGHQ/HSBC on 18/07/2007 16:49 -----

Ramon GARCIA/HBMX/HSBC HBMX 18/07/2007 To: David W J BAGLEY/HGHQ/HSBC@HSBC  
 14:43 Mail Size: 11818 cc:  
 Subject: Fw: Weekly Compliance Report 02JUL-06JUL07  
 Entity: HSBC Holdings plc - HGHQ

David,

I will discuss the subject below with Warren and John in our Conference Call tomorrow. I would like to let you that the procedure and functions of the money laundering committee (CCC) have been improved in a very important way.

The 2 cases reported at the weekly compliance report is a clear example of the escalation process implemented as one of the learning experiences after [REDACTED] and other cases.

I understand that the appreciation from GHQ is that the CCC has to resolve and rule about all the cases presented to the attention of the committee but the real situation is that sometimes there are some cases that need to be escalated to the Business Head and CEO for further discussion.

As I told you when you were in Mexico, CCC is a very unique body created by Mexican regulation in order, among other things, to dilute responsibility of MLD obligations between members, giving a very important weight to business opinions because in theory they are the ones that really know the customer. For that specific situation escalation is a key element when MLD has a different opinion that the one from the business about reporting the case to authorities.

I will explain Warren and John tomorrow the different actions plans I am reviewing with John Rendall including the one originated after your visit in order to have better procedures at the MLD function including the CCC.

Regards,

Ramon

----- Forwarded by Ramon GARCIA/HBMX/HSBC on 18/07/2007 08:09 a.m. -----

John F ROOT/HGHQ/HSBC 17/07/2007 06:16 To: Ramon GARCIA/HBMX/HSBC@HSBC

Permanent Subcommittee on Investigations  
 EXHIBIT #19

Redacted Material  
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HSBC OCC 8875925

a.m.

cc Susan A WRIGHT/HGHQ/HSBC@HSBC, Warren G  
LEAMING/HGHQ/HSBC@HSBC, David W J  
BAGLEY/HGHQ/HSBC@HSBC  
Subje Fw: Weekly Compliance Report 02JUL-06JUL07  
ct

Ramon,

A number of items jump out from your most recent weekly report (02JUL-06JUL) but everything pales in comparison with the ML items on page 4. It looks like the business is still retaining unacceptable risks and the AML committee is going along after some initial hemming and hawing. I am quite concerned that the committee is not functioning properly. Alarmed, even. I am close to picking up the phone to your CEO.

[REDACTED] looks like another [REDACTED] type of situation -- what on earth is an "assumption responsibility letter" and how would it protect the bank if the client is a money launderer? Please note that you can dress up the USD10 million to be paid by one of [REDACTED] partners to the US authorities as an "economic penalty" if you wish but a fine is a fine, and a hefty one at that. What is this, the School of Low Expectations Banking? ("We didn't go to jail! We merely signed a settlement with the Feds for \$10 million!") I just loved the last sentence of the paragraph: "This information is expected to be spread by mass media." Isn't that just great?

So, [REDACTED] is strike one, [REDACTED] is strike two. Let's now look at strike three. (I hope you like baseball.)

The same person who is giving the sacrosanct "assumption responsibility letter" for [REDACTED] (Jose Manuel Domínguez, DGA-CMB) is being asked by the CEO to explain why he retained the [REDACTED] relationship after USD11 million was seized by the authorities in [REDACTED] account with Wachovia in Miami. What? The business was okay with this?

The AML committee just can't keep rubber-stamping unacceptable risks merely because someone on the business side writes a nice letter. It needs to take a firmer stand. It needs some *cojones*. We have seen this movie before, and it ends badly.

Regards,

John Root

----- Forwarded by John F ROOT/HGHQ/HSBC on 17/07/2007 11:46 -----

Ramon GARCIA/HBMX/HSBC HBMX 14/07/2007 To Warren G LEAMING/HGHQ/HSBC@HSBC, John F  
00:58 Mail Size: 156258 ROOT/HGHQ/HSBC@HSBC  
cc Laura YESINI/HBMX/HSBC@HSBC  
Subje Weekly Compliance Report  
ct  
Enty HSBC Holdings plc - HGHQ

Redacted Material

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HSBC OCC 8875926

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Warren, John,

Please find enclosed Weekly Compliance Executive Report for the period from 02JUL07 to 08JUL07.  
[attachment "Weekly 28 07 sum.doc" deleted by Ramon GARCIA/HBMX/HSBC]  
Regards,

Ramon

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PAUL A THURSTON for John R RENDALL 07/27/2007 01:52 AM  
Cc: Ramon GARCIA, Leonardo ARANA, "Jose Manuel Dominguez"

John,

On the evidence of the papers that you have provided to me, I agree that the quality of the information provided by CMB does not give any comfort that they have rigorously reviewed this case - they seem to have focused on managing out the credit risk, but without considering the reputational risks.

On this basis, I support in principle the recommendation to close the account.

However, it has to be noted that it would be a sensitive message to send, to say that we are not prepared to deal with a company that is regulated by CNBV, as this could be embarrassing for them if it became public, which is always possible. I think we should therefore have a private conversation with CNBV in the first instance, to advise them of our intent and the potential reputational risks for them, and seek their "no objection" to our action.

Please can you arrange for this to be done, and then revert to me.

Thanks

Paul

John R RENDALL

Original Message

From: John R RENDALL  
Sent: 07/25/2007 08:11 PM CDT  
To: Paul A THURSTON  
Cc: Ramon GARCIA, Leonardo ARANA  
Subject: Paul

Paul,

This is the second case from CCC requiring escalation.

In this case I recommend that we support the CCC closure recommendation.

The principal factor here is that the quality of response from the CMB team has not been of the standard that leads me to believe that they are on top of the compliance risks here.

Unlike the other case, this is a Mexican-regulated institution.

The only caveat to this recommendation is that I suggest Ramon raise with his US counterpart as I believe that there is a relationship there also.

John R RENDALL

DGA de Operaciones y Administración | HSBC Mexico SA  
Paseo de la Reforma 347 Oficina 21  
Col. Cuauhtémoc, 06500 Mexico DF

Phone: 00 52 55 5721 2899  
Fax: 00 52 55 5721 2922  
Email: John.R.RENDALL@hsb.com.mx

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Permanent Subcommittee on Investigations  
EXHIBIT #20

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HSBC OCC 8875132

Forwarded by John R RENDALL/HBMOX/HBSC on 25/07/2007 08:05 p.m.

Antonio M.  
CRUZ/HBMOX/HBSC  
HBMOX  
24/07/2007 01:07 p.m.  
Mail Size: 2307735

To: John R RENDALL/HBMOX/HBSC/HBSC  
cc: luis.vega@hbsc.com.mx, ferny.bled@hbsc.com.mx,  
marcela.angelini@hbsc.com.mx  
Subject: Fw: [REDACTED]  
Entry: HSC Bank plc - MOBA

John:

In response to the e-mail sent to Luis Vega (he is on vacations) last Friday with respect to [REDACTED], we comment the following details:

1.- Attached to this e-mail please find the legal actions that [REDACTED] has taken to this date:

- Petition for Return of Seized Funds [REDACTED] has the complete document which contains more than 33 pages. If you need it let us know

[attachment "Petition de devolucion de fondos retenidos Corte Civil.pdf" deleted by Paul A THURSTON/HBMOX/HBSC]

- 2 Notices of Seizure [REDACTED] from the US Department of Justice Drug Enforcement Administration to [REDACTED]. These are the missing documents in Luis Vega's e-mail.

[attachment "NOTICE OF SEIZURE.pdf" deleted by Paul A THURSTON/HBMOX/HBSC]

- 2 Letters contesting the forfeiture of the seized property and 2 Certificates of Acknowledgement of Execution of an Instrument issued by the US Embassy in Mexico.

[attachment "Certificate embassy [REDACTED].pdf" deleted by Paul A THURSTON/HBMOX/HBSC]

[attachment "Certificate embassy [REDACTED].pdf" deleted by Paul A THURSTON/HBMOX/HBSC]

[REDACTED] General Manager told us that they will not take any legal action vs Wachovia Bank before knowing a District Court's resolution.

- 2.- [REDACTED] suggested to the Compliance Committee to keep operating with [REDACTED] supported by the arguments established in the Luis Vega's mail (word document). As [REDACTED] mentioned, the credit facilities were cancelled. The business operations that the bank is doing now with [REDACTED] are: draws and deposits from and to its checking accounts, and, currency exchange transactions OVP.

Besides, [REDACTED] suggested to the Compliance Committee to inform to the Mexican financial authorities about the [REDACTED] situation regarding the seizure of funds at Wachovia Bank.

- 3.- [REDACTED] considers this event as a low reputational risk operation due to [REDACTED] has had an excellent experience at the financial market in the past 22 years. It is a regulated entity by the CNBV.

2/5

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HSBC OCC 8875133

which has met all the authorities requirements, mainly, in the IICR transactions issues. By the other hand, [REDACTED] seizure of funds was originated by an specific operation (if it is true) which does not involve the whole company.

If you need more information please let us know

Antonio Cruz  
Director Regional  
Región SUR

Forwarded by Antonio M CRUZ@HBMX@HSBC on 24/07/2007 11:53 a.m.  
Luis VEGA@HBMX@HSBC  
20/07/2007 07:08 p.m. To: antonio.m.cruz@hsbc.com.mx, Fanny BLEDLIN@HBMX@HSBC  
cc  
Subject: Fw: [REDACTED]

Esto es lo que hoy que contestar..

Luis VEGA  
Director Regional Sur | HSBC México  
Av. Tlalacón Sur 183 Cda. La Paz  
C.P. 72100 Puebla, Pue.

Phone: (52-21) 2225-8401  
Fax: (52-22) 2225-8405  
Email: Luis.Vega@hsbc.com.mx

Forwarded by Luis VEGA@HBMX@HSBC on 20/07/2007 07:07 p.m.  
John R RENDALL@HBMX@HSBC  
20/07/2007 11:29 a.m. To: Luis VEGA@HBMX@HSBC@HSBC  
cc  
Subject: Re: Fw: [REDACTED] Link

Luis,

3/5

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This is painful but I would appreciate further details of:-

1. [REDACTED] position wrt Wachovia actions. What is their defence to these charges and how do they plan to pursue that defence.
2. You state that [REDACTED] has taken protective measures to keep operating with [REDACTED] without any direct credit risk. My principal interest here is in Compliance risk and reputational. Please explain in detail how you are managing these risks.
3. Your document refers to an attached legal document which is missing. If this is relevant, please forward.

Thanks

John R RENDALL  
DGA de Operaciones y Administración | HSBC México SA  
Pasaje de la Reforma 347 Oficina 21  
Cdt. Cuauhtémoc, 06500 México D.F.

Phone: 00 52 55 5721 2809  
Fax: 00 52 55 5721 2922  
Email: John.R.RENDALL@hsbc.com.mx

Luis VEGA@HSBC  
HSBC

2007/07/27 10:48 a.m.  
New Email: 32511

To John R RENDALL@HSBC

Subject: Cw: [REDACTED]

John I am sending you an attach with information about [REDACTED] as you required.

Regards

Luis VEGA  
Director Ejecutivo Region Sur | HSBC México  
Av. Yauhtzin Sur 102 Cdt. La Paz  
C.P. 72100 Puebla, Pue.

Phone: (52-22) 2225-9601  
Fax: (52-22) 2225-9605  
Email: Luis.Vega@hsbc.com.mx

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HSBC OCC 8875135

From: Michael F GEGHEGAN  
 Sent: 23/10/2007 13:55 GDT  
 To: Z J CAMA  
 Subject: Fw: CNBV Inspection

Zed

For your eyes only at this time

Mike

HSBC Holdings plc  
 Registered Office: 8 Canada Square, London E14 5HQ, United Kingdom  
 Registered in England number 617967

----- Original Message -----

From: Michael F GEGHEGAN  
 Sent: 23/10/2007 08:43 GDT  
 To: Paul A THURSTON  
 Cc: Stephen GREEN; Matthew J W KING  
 Subject: Re: CNBV Inspection

Dear Paul

This is disturbing and clearly we will need to look at the management structure and practices. Would these views from CNBV be shared by our Internal Audit locally?

We should wait to see what the official letter says but it will be hard to impress on management the need for a change of direction if you are not allowed to use the content of your meeting.

I am copying this to the Group Chairman and Matthew King for their information

Best wishes

Mike

Permanent Subcommittee on Investigations  
 EXHIBIT #21

Confidential - FOIA Treatment Request

HSBC OCC 8873338



HSBC Holdings plc  
 Registered Office: 8 Canada Square, London E14 5HQ, United Kingdom  
 Registered in England number 611987

----- Original Message -----

From: Paul A THURSTON  
 Sent: 23/10/2007 02:18 CDT  
 To: Michael F GEOGHEGAN  
 Subject: CNBV Inspection

Mike,

At their request, I met today with the Head of Banking Supervision, and the Supervisor for HSBC, from our regulator, the CNBV, following their on site examination of various aspects of our business, including cards, money laundering and treasury operations. Although they have had closing meetings with the respective departments, they asked to meet with me alone, on a strictly private and confidential basis.

They walked me through a presentation pack which firstly set out specific points that had arisen during their inspection, but then moved on to more general concerns of the CNBV with HSBC in Mexico. These centred on:

- weaknesses in internal controls which they saw in several areas of HSBC, citing evidence of the level of credit card frauds, numbers of customer complaints to the bank and to the banking ombudsman, customer concerns that staff in branches do not have appropriate training and qualifications, frequency of IT failures, and slow progress in tackling KYC data problems and anti money laundering procedures.

- corporate culture, where they comment that since the purchase of Bital, HSBC has driven growth in credit products and launched new products without adequate controls. They acknowledged the addition of new senior executives including the CFO and COO, and they welcomed these, but they are concerned that some areas of the business have not changed at all in mentality, or approach, despite the changing name of the business, and some lower level staff have not been adequately trained to deal with the business now being undertaken. They implied that they considered that we were still running parts of the bank as if they were still Bital, despite the new ownership and the change in business profile.

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HSBC OCC 8873339

They also expressed concerns at senior management having dual responsibilities for Mexico and the region, stating that "there are many concerns on how management will be able to implement strong controls within the bank in Mexico, while keeping an eye on other countries".

Their final slide reads as follows:

#### REQUIREMENTS

As a result of the concerns pointed out, the CNBV needs the senior level commitment to solve the problems surfaced. In order to do that, HSBC needs to set corrective programmes. These actions should include the following:

- set strong internal controls in key business and operational areas
- adopt measures to stop frauds, reduce clients's complaints and improve the level of service, to reduce reputational risk
- establish the necessary actions to improve IT performance and avoid technological risks caused by systems break down
- manage an effective culture of change
- avoid sharing senior officers responsibilities with LATAM
- set effective measures regarding money laundering issues
- avoid taking excessive credit risks in the credit card portfolio and set actions to assess this risk in an adequate manner."

They have told me that their presentation pack is for my eyes only, and not to be shared with others in the bank, probably recognising that CNBV do not want to be seen to be getting actively involved in issues that touch upon the people in the bank. They will issue a normal management letter in due course, without including some of the more sensitive areas, but they wanted to bring these to my personal attention to let me know of their concerns.

I indicated to them we were aware of these issues and were progressively tackling them. I advised them of the new appointments of an experienced Head of consumer risk with experience in Asia, who arrived a couple of weeks ago, and a new Head of card Fraud from GMD who arrived yesterday, the help we had sought from Ken Harvey to review the robustness of the IT operations and the planned internal audit of IT in November, and the major programme of customer file centralising and imaging which would give us more robust KYC data for anti-money laundering. I talked about changes we are making to split Regional from Mexico responsibilities in areas such as CIBMA, IT, Risk and Audit, but they advised that their specific concern here was with PFS, and I indicated that they could also expect changes in this area in the near future.

I said that we were embarked on changing the business models of the bank, and bringing in specialist expertise, but that culture change would not happen overnight. However, I believed that the infusion of new management, combined with changes we were planning to incentive schemes to put more emphasis on customer satisfaction and business quality would help push the bank in the new direction. I commented that we have a young staff, and while they lacked experience, I was confident that if we were clear in our business direction to them, and gave them appropriate training, and measures, we could make real progress.

I told them that I welcomed their coming to see me, and that we would respond positively to the management letter, when it arrives, and that I would also meet up with them again to update them on progress with the issues not covered in the management letter.

They indicated that this was what they wanted to hear, and that they would report back positively to Guillermo Babatz, the Head of the CNBV.

I took the opportunity to remind them of the issues that I had raised with them and Babatz two months ago on the PTU (profit sharing tax), where Bancomer and Banamex had been allowed to take action to avoid payment, and they acknowledged that we would also have to take action if we were to remain competitive, and they indicated that while they didn't like it, they would not object provided that our solution was within the existing laws and regulations.

I will follow up on all of these points, but thought that you should be aware.

VerDate Nov 24 2008 14:41 Nov 19, 2012 Jkt 076061 PO 00000 Frm 00698 Fmt 6601 Sfmt 6601 P:\DOCS\76061.TXT SAFFAIRS PsN: PAT

From: Susan A WRIGHT  
 Sent: Fri Nov 16 15:59:21 2007  
 To: Warren G LEAMING  
 Cc: David W J BAGLEY  
 Subject: Mexico  
 Importance: Normal

Warren,

I believe you are visiting Mexico shortly.

One of my action points from the Conference is to follow up with Ramon GPP 25 application in Mexico (and elsewhere within Ramon's area of responsibility). As you will no doubt recall GPP25 is known perhaps more fondly across the Group as "Two strikes (NOT 2.5!) and out". At the conference Ramon mentioned that there are numerous cases of accounts with multiple SARs (16 in one case!) in Mexico that remain open. I would be grateful if you could follow up on this during your visit. Happy to discuss.

Thanks

Regards Susan

Permanent Subcommittee on Investigations

EXHIBIT #22

Confidential - FOIA Treatment Request

HSBC OCC 8875423

From: John F ROOT  
 Sent: Thu Dec 06 16:01:10 2007  
 To: Warren G LEAMING  
 Subject: Fw: Warren Learning HBMX DEC Visit Issues  
 Importance: Normal

Re-send.

----- Forwarded by John F ROOT/HGHQ/HSBC on 06/12/2007 16:00 -----

John F ROOT/HGHQ/HSBC HGHQ 16/11/2007 10:27 Phone No. : 7992 5555 40044 (207) 7992 992 5555 Mail Size: 3356	To: Warren G LEAMING/HGHQ/HSBC@HSBC cc: David W J BAGLEY/HGHQ/HSBC@HSBC Subject: Warren Learning HBMX DEC Visit Issues et Entity: HSBC Holdings plc - HGHQ
---	--

Warren,

I am keeping a running list of issues that you might want to raise during your December visit to HBMX. If you or David would like to add to the list, please let me know.

The list below is only partial, and I am constantly adding to it. There is of course overlap with David's visit recommendations.

Worse annual "31-point" Central Bank (Banxico) inspection of HBMX than last year's. Why have Treasury operations deteriorated?

Resourcing, especially Regional head vs. Mexico head; CIBM; and MLRO)

Sinaloa massive money-laundering scheme (+ USD 100 million)

Regional integration, e.g. Honduras, Panama reluctant to accept CMP requests from Mexico, monitoring, etc.

Clean-up of HBMX Trusts backlog

Smooth, independent functioning of HBMX MLD committee

CIBM HBUS Venezuelan business through Panama

Banistmo business in regulatory and tax havens

Relations with Legal, Audit, senior management, regulators (Mexico and Central America)

AML systems integration (Mexico and Central America)

Regards,

John Root

Permanent Subcommittee on Investigations <b>EXHIBIT #23</b>
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HSBC OCC 8875837

**GROUP AUDIT MEXICO  
AUDIT REPORT SUMMARY SCHEDULE  
GRQ REPORTABLE AUDITS**

Name of Audit	HBMX - MONEY LAUNDERING DETERRENCE (MLD)			Region: Mexico
Business or Customer Group	Central Support High	Audit Committee		HBMX
	Date	Inherent Risk	Control Risk	Overall Risk
This Audit	DEC07	High	Below Standard	High
Last Audit	N/A	N/A	N/A	N/A

**Nature of Business**

The areas involved in the process (business lines) are responsible for applying MLD processes defined and issued by Local MLD Department on: KYC (Know your Customer), files integration, proper input of customers' information in the system, validation of alerts sent by the DPLD and effective response thereto. Due to the foregoing, this review was oriented to review DPLD operations, yet it covered a number of areas involved in the detection of ML activities and compliance with governing laws and regulations.

**Conclusion of Audit**

Main control weaknesses identified during the audit were as follows:

**KYC**

- Regulatory breaches in KYC issues such as the large number of incomplete client files and the inadequate process of SCC identification and monitoring across the network.
- HBMX has been given an extension by the Regulator from May 07 to May 08 to ensure that a portion of the client files (known as the UBA project-about 1.8m customers) are completed. Due to our concerns with the reliability of the system used to measure this process is unclear on exactly where the bank is in relation to being able to meet this deadline.
- As at May 07 HBMX had advised the Regulator we were at 80% whereas all audit samples both in this audit and the regular branch audits conducted over the year give a much lower percentage. The latter number is hard to extrapolate from a sample basis but is as low as 40% of file integration, meaning the job in hand to reach 100% in 6 months is very challenging.
- The UBA number excludes the almost 6 million other clients the Group has in Mexico which are subject to HSBC's own MLD policies, where sampling also gives a similar low number of complete files. As this problem had been identified some months ago the COO was appointed to oversee and coordinate a task force to manage this matter, further details appear in the report.

**Delays in reporting**

- Delays in reporting mutual transactions to the Regulator due to increased number of cases to be sanctioned by the AML Committee and slow decision-making in the process.

**Systems and Tools**

- Lack of sufficient understanding of the IT processes and tools necessary to enhance MLD activities and capacity as evidenced by the lack of a reliable system to track client files integration, inadequate ability to screen black lists and inadequate monitoring SCC/PEP's etc.

**Training**

- We also noted the need to re-assess the overall approach to MLD training as a result of failures regularly identified in branch audits, and the need to upgrade several of the IT systems in use to ensure better control over both Regulatory and Group policies and procedures.

To ensure that there is one overall integral approach to resolve the issues, in view of the number and in many cases seriousness of the weaknesses identified, we would recommend the creation of an Oversight body, possibly a HBMX Money Laundering Committee, to implement both a short and longer term plan to ensure that the issues raised in this report can be fully addressed. This body will need to have sufficient empowerment and proactivity to drive through some of the measures needed to comply with both local and Group policies and procedures, especially in the time periods involved.

**Response from Management**

The first response to the audit is due on 17 JAN 08.

Permanent Subcommittee on Investigations

**EXHIBIT #24**

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N.A. HSBC OCC 8876347

From: David W J BAGLEY  
Sent: Fri Jan 30 08:02:44 2009  
To: Susan A WRIGHT  
Subject: Re: US Issues - Various  
Importance: Normal

Susan,

An obvious learning point for HBMX is that if they were contacted by US authorities then they should have thought to advise HBUS. They can go round the web, not just through the middle of the web.

Regards

Permanent Subcommittee on Investigations  
**EXHIBIT #25**

Confidential - FOIA Treatment Request

HSBC OCC 8873759



HSBC-BNI\_E 0591006.txt  
 From: TERESA PESCE/HBUS/HSBC  
 Sent: 12/15/2006 9:59:00 AM  
 To: ELIZABETH PROTOMASTRO/HBUS/HSBC@HSBC  
 CC: ANNE LIDDY/HBUS/HSBC@HSBC; DONALD W MCPHERSON/HBUS/HSBC@HSBC; GRACE C SANTIAGO-DARVISH/HBUS/HSBC@HSBC;  
 JOHN ALLISON/HGHQ/HSBC@HSBC  
 Subject: Re: OFAC - Wire payments blocked from HSBC offshore entities - USD 32,000 (re SDGT) and USD 2,538,939.33 (re Sudan)

How is it that these payments continue to be processed by our affiliates in light of the GCLs?

Teresa A. Pesce  
 EVP/Managing Director  
 Anti-Money Laundering Compliance  
 HSBC North America Holdings  
 452 Fifth Avenue  
 New York, NY 10018  
 ph - (212) 525-6099  
 fax - (212) 525-5769

Elizabeth Protomastro/HBUS/HSBC  
 12/14/2006 06:02 PM

To  
 John ALLISON/HGHQ/HSBC@HSBC  
 CC  
 Teresa Pesce/HBUS/HSBC@HSBC, Anne Liddy/HBUS/HSBC@HSBC, Grace C Santiago-Darvish/HBUS/HSBC@HSBC, Donald W McPherson/HBUS/HSBC@HSBC  
 Subject  
 OFAC - Wire payments blocked from HSBC offshore entities - USD 32,000 (re SDGT)  
 and USD 2,538,939.33 (re Sudan)

This email is to inform you of the following two payments, initiated by HSBC offices, and blocked due to OFAC sanctions. The first was blocked under terrorist sanctions. The second was blocked due to involvement of a Sudanese SDN.

Value date 9-Nov-2006  
 Debit: 000054356, HBME Ramallah Br., Ramallah Palestine  
 Credit: JP Morgan Chase, Tampa, FL  
 3rd party: Arab Jordan Investment Bank S.A., Amman, Jordan  
 ORG: HBME, Ramallah, Palestinian Territory, Occupied  
 BBI: Acc/For further credit to Palestine Investment Bank Head Office Ramallah  
 branch account 6171 for further credit to Al Aqsa Islamic Bank  
 USD 32,000.00

Note that Al Aqsa Islamic Bank was designated by OFAC on 4-Dec-2001 as a "specially designated global terrorist". The press release from Treasury stated that it is a "direct arm of Hamas, established and used to do Hamas business." Below are links to the press releases.

<http://ustreas.gov/press/releases/po837.htm>

<http://ustras.gov/offices/enforcement/ofac/actions/20011204.shtml>  
 Page 1

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Permanent Subcommittee on Investigations  
**EXHIBIT #26**

, Inc. HSB03793250  
 HSBC OCC 3407608

HSBC-BNI\_E 0591006.txt

<http://ustreas.gov/press/releases/po841.htm>

The payment was held at the direction of OFAC and additional information requested. On 20-Nov-2006, HBME sent a SWIFT message to cancel the payment as it was sent in error. On 7-Dec-2006, OFAC instructed HBUS to block the funds.

Details are below on the payment blocked under the Sudan sanctions.

Value date 6-Dec-2006

Debit: [REDACTED] HSBC Bank PLC (JOH), Johannesburg branch

Credit: BNP Paribas New York

3rd party: BNP Paribas (Suisse) SA, Geneva

4th party: Sudanese Petroleum Corporation

ORG: Ethiopian Petroleum Enterprise

OGB: Commercial Bank of Ethiopia, Ethiopia

OBI: Inv/M/10/2006.Dated Nov 05/06

USD 2,538,939.33

"Sudanese Petroleum Corporation" is listed by OFAC as an SDN under the Sudan program.

Please let us know if you have any questions or need any further information.

Thank you.

[REDACTED] = Redacted by the Permanent Subcommittee on Investigations

From: Matthew J W KING  
 Sent: Fri Feb 22 17:55:16 2008  
 To: "Paul A THURSTON"; Graham THOMSON  
 Cc: "Richard E T BENNETT"; David W J BAGLEY  
 Subject: CNBV  
 Importance: Normal

This was the note I was thinking of sending to Mike - a bit of a brain dump and not fully up-to-date or polished but I thought I would send it to you as is because it might help focus the call we are due to have later.

"Mike,

My perspective on these issues from my discussions with Paul Thurston, Graham Thomson and Chris Bentley is as follows:

The issues raised by CNBV appear to be pretty similar to those raised previously with Paul. However, whereas the CNBV previously seemed broadly happy with our remedial action plans, they have suddenly become more aggressive. Whether this is because of political pressure, the FIU suddenly raising significant concerns (which perhaps the CNBV thinks reflects poorly on them), it is difficult to say. One theory about the FIU is that they are reacting to our refusal to reimburse a public utility (which also ultimately reports into the Ministry of Finance) for a large internal fraud, effected through our Internet services. [REDACTED] but the CNBV has raised concerns about our security arrangements and the matter has now been mentioned to us by the FIU. Whatever the truth of this, it is also the case that Mexico is suffering a major problem with drugs dealers and the Government is being very robust about dealing with them. Hence any AML weaknesses may well be treated similarly. The 'evidence' obtained from the FIU does not seem very earth-shattering. There is nothing I have heard which could not equally be put down to carelessness or common mistake (I am not excusing this you understand). However, the necessary investigation work is still underway.

There are areas of known weakness which management have been addressing but where we now need to revisit the current strategy:

Moneylaundering - This area was rated as Below Standard on a Q407 audit and work has been underway since then to address the weaknesses. The Chief Moneylaundering Officer is being replaced, albeit the FIU apparently regard him as trustworthy - management are well-aware that his departure will therefore have to be carefully explained. Various processes are being enhanced. David Bagley is proposing to send in Warren Learning as a temporary measure to ensure these are now treated as matters of utmost urgency.

KYC - My area of biggest immediate concern - this has been a systemic issue for some time. Enhanced regulations were enacted a few years ago and implementation of these has proved problematic for HBMX. One particular problem has been the requirement to undertake visit reports for every new customer at their home/business address. Perhaps because of the extended HBMX branch opening hours this has proved particularly difficult for the branches to achieve. It also inhibits centralisation of the account opening process which has been one of the key solutions to similar problems elsewhere. We (audit) and the CNBV have both identified a very high rate of exceptions (around 50%) to the process, though this level is disputed by the business. A pilot scheme has been running since Q307 to use imaging (and hence assist centralisation). However, I now gather Audit is continuing to identify a high level of exceptions for that process also (around 30%).

Given the concerns now raised by the CNBV and FIU (which apparently includes tapes of a drug lord recommending HBMX as the place to bank) we now have to decide:

whether the imaging process can be made to work to everyone's satisfaction.

how quickly it can be rolled out across the whole network.

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Permanent Subcommittee on Investigations

EXHIBIT #27

HSBC-PSI-PROD-0198508

in the meantime, whether we can continue to open accounts using the old, flawed process.

It sounds unlikely that we will be able to meet a deadline of MAY08 to obtain satisfactory KYC on the 1.8 million customers identified as high risk. I am now not clear whether the CNBV will accept a further delay - the previous indications were that they were pretty relaxed.

Documentation - This has been a problem since we brought Bital. I am aware the old storage depots have been replaced, but I am advised the processes are still a mess. Sorting this out needs to be handled as a specific project. It may be worth asking Ian Macalister to run this. He is an IM currently with CMB in NY who previously had responsibility for sorting out a documentation problem in the trust business in Mexico.

Reporting to the FIU - We apparently route responses through a law firm. It is not clear why or indeed whether this is sinister or just inefficient. However, it does seem that incorrect evidence has been provided via this law firm. There is a very high volume of informational requests but we need to ensure these are handled with due care.

Management Stretch- the CNBV has again raised the appropriateness of allocating regional responsibilities to HBMX management. It may be that you are already close to sorting this out.

Cross-border cash: the trends in this activity still need to be clarified by HBMX but as I read the report the US authorities have a general concern rather than a specific one about us, and CMP last year identified and acted on a cambio which has just been closed down by the authorities. We can therefore show some successes.

I hope this is helpful background (though a bit long). If you wish to discuss please call me on my mobile [REDACTED] - I will be in France for the weekend but please feel free to phone at anytime. I have not copied HBMX though the points raised have all been discussed with Paul, Graham and Chris.

Regards,

Matthew King

\*\*\*\*\*

HSBC Holdings plc  
Registered Office: 8 Canada Square, London E14 5HQ, United Kingdom  
Registered Number 617987

\*\*\*\*\*

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**HSBC-PSI-PROD-0198509**

From: [REDACTED]  
 To: Paul A THURSTON; John R RENDALL  
 Sent: 02/04/2008 01:30 AM

John,  
 I am out of the office tomorrow, but think we should respond to Group on this by the end of the week - would it be possible for you to finalize your discussions with Ramon and revert direct to Begley, on my behalf?  
 Thanks  
 Paul

John R RENDALL/HBMOX/HSBC

From: John R RENDALL/HBMOX/HSBC  
 Sent: 04/02/2008 07:40 p.m.  
 To: Paul A THURSTON/HBMOX/HSBC  
 cc: "Ramon Garcia Gibson" <ramon.garcia@hsbc.com>  
 Subject: Re: [REDACTED]

This was one of the two cases that we referred to you a couple of months back - the other was [REDACTED]  
 Our recommendation, which you supported, was to maintain this relationship. It was based on the following factors:  
 A) our CMB team in Tijuana were relatively on top of the case  
 B) the events for which [REDACTED] have been fined were relatively historic - from memory, 2-3 years ago, and significant improvements had been made since then.  
 Ramon visited the customer personally in December and was happy to support the continuation of the relationship.  
 I will discuss the specifics raised in Susan's email with Ramon tomorrow and revert.  
 By way of contextual info, we are under some informal pressure from CNBV to maintain quality [REDACTED] type business relationships at present.  
 All in all, I would suggest that we do an industry policy review for agreement. Ramon should lead but draw on CMB and CIBM input too.

John  
 Paul A THURSTON  
 Original Message

From: Paul A THURSTON  
 Sent: 02/04/2008 01:24 PM CST  
 To: John R RENDALL  
 Subject: [REDACTED]

John,

1/3

Permanent Subcommittee on Investigations  
 EXHIBIT #28

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HSBC OCC 8875139

Please can you let me know what the situation is here.

Thanks

Paul

David W J BAGLEY

Original Message

From: David W J BAGLEY  
Sent: 02/04/2008 04:46 PM GMT  
To: Paul A. THURSTON  
Subject: [REDACTED]

Paul,

I have been copied in on the attached note from Susan Wright to Ramon which covers a number of issues but in particular the situation relating to [REDACTED] whom I am advised is a customer of Mexico CMB. Also attached is a Compliance article which summarises the background to the US federal sting operation and the US Department of Justice's record fine.

I am not sure whether this relationship has been referred to you for consideration. We have previously recommended closure of the relevant accounts. I understand, however, that in spite of the seriousness of this case and the issues involved, CMB is proposing to retain this relationship. There are a number of aspects which give rise to concerns:-

- MSBs are inherently high risk given their vulnerabilities in relation to money laundering and more recently terrorist financing. For this reason since 2000 the Group has included MSBs within the SCC policy. Consequently should only establish relationships with well regulated MSBs with a strong underlying culture and controls.
- [REDACTED] had with operating an MSB with a deficient AML programme which has led to systemic violations and a record fine by the US authorities. In particular the case demonstrates that it has had little control over its numerous agents. Whilst the company will now need to take steps to address these deficiencies this will inevitably take some time, and instilling the appropriate culture within the business even longer.
- I am not clear as to how the accounts maintained with us operate and if indeed we are able to identify activity on a daily basis. If we receive transactions which reveal the name of the remitter and the beneficiary we would be able to screen names against sanctions/terrorist lists and we may also be able to monitor transactions for certain patterns, although of course this is by no means foolproof. The enhanced controls we will need to introduce will represent a significant cost in terms of time and resources. If, however, we receive batched transactions then we are heavily reliant on the MSB for screening/monitoring purposes.
- We have been advised that we are not [REDACTED] only brokers in Mexico. It is possible that a number of the other banks may now be considering terminating their relationship, given the seriousness of this case, which may lead to an increase in the volume of transactions seen through any remaining bank/s, increasing the risk even further.

I would of course be pleased to discuss further with you but given the above and the potential risk to the Group, not only in Mexico but also the US, I would strongly recommend that any decision to continue with this relationship should be reconsidered.

Kind regards David

[attachment "compliance(2).pdf" deleted by John R. RENDALL\HBMX\HSBC]

2/3

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HSBC OCC 8875140

Susan A  
WRIGHT/HQHQ/HSBC  
HQHQ  
0162/2008 10:24  
Phone No. 799 2554  
H4 (1) 20 7992 5554  
Mail Size: 4773

To: Ramon GARFIA/HQHQ/HSBC@HSBC  
cc: Warren G LEAMON/RLA LGA MEMBERS/HSBC@HSBC,  
John P ROOT/HQHQ/HSBC@HSBC  
Subject: [REDACTED]  
Entity: HSBC Holdings plc - HQHQ

Ramon,

Ramon,

Good to talk to you yesterday. I thought it would be worthwhile following up on a number of issues we discussed yesterday:-

- Embassy Controls - I would recommend that you liaise with Anne Liddy re the introduction of appropriate controls for managing embassy/consulate accounts. Please make this a generic enquiry (i.e. do not refer to any specific embassies). You may initially wish to pick up the phone to Ann but she will certainly be able to provide you with copies of appropriate profiles and supporting procedures/controls.

- [REDACTED] If the business wishes to maintain this relationship then, as previously mentioned, these accounts/transactions will need to be closely monitored and subject to frequent reviews (recommendation should be for quarterly reviews in current circumstances). The actions by the US regulator should be used as a trigger event and our due diligence on this client updated. In this connection the high risk profile that is in place for Financial Institutions should be used. Please let me know if you need a copy of this. This profile asks for details of the FI's AML controls, due diligence and screening. With regard to screening I am not aware as to what type of transactions we see and in what currency. Do we see individual transactions where the underlying remitter/beneficiary are named and, if so, do we screen these? If we only see batched transactions then we are relying on the screening undertaken by [REDACTED] It would be helpful to understand the nature of these transactions and currencies involved - could you provide me with an overview? We should also monitor the volume - you mentioned that we are not [REDACTED] only bankers in Mexico. If, however, any of the other banks withdraw then we may well see the volume of transactions through us rise and our exposure/risk will increase with a corresponding increase in the cost of monitoring etc.

- CAMP Governance documents - I have sent you these under cover of a separate email

- HSBC El Salvador - I have sent you a separate note on this re a review of the cross border remittance business with Bancasol and 3rd parties.

Please let me know if you need anything from me or if you have any queries.

Regards Susan

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HSBC OCC 8875141

Complinet

Page 1 of 2

## complinet

### Money laundering 'sting' led to MSB's record penalty, says legal pact

Jan 29 2008 Brett Wolf

California-based money transmitter Sigué Corporation has agreed to forfeit \$15m and spend \$9.7m on anti-money laundering compliance this year to settle US Department of Justice charges that it operated with a deficient AML program. Sigué's woes stem from the fact that dozens of its agents were snared by a federal sting operation dubbed "Operation High Wire," according to the deferred prosecution agreement, or DPA, released on Monday and obtained by Complinet.

This record-setting Bank Secrecy Act penalty — the largest ever suffered by a money services business — was well earned, according to the DPA. Still, the agreement states that the government will recommend the dismissal of the charge against Sigué in 12 months if the firm takes the agreed remedial action and does not violate the terms of the DPA.

"The violations at Sigué were serious and systemic, and allowed tens of millions of dollars of suspicious financial transactions to be conducted through Sigué, including transactions involving funds represented by undercover US law enforcement agents to be drug proceeds," according to the DPA, which Complinet heralded in an earlier article.

The DPA alleges that Sigué, an international money remittance company that specializes in transfers to Mexico, violated the Bank Secrecy Act, Title 31 USC Section 5316(h)(1) and 5322(a). According to the DPA's statement of facts, these BSA violations occurred between November 2003 and March 2005 and involved Sigué money transmitting agents, most of which were "mom and pop" shops.

"Sigué authorized delegates knowingly accepted and transmitted more than \$500,000 of money represented by undercover US law enforcement officials to be proceeds of drug trafficking. The money used in the undercover operations was received by and wired through 59 separate Sigué authorized delegates in 22 states," the DPA stated.

"Drug money" flows to "source of supply"

According to the DPA, undercover officers approached Sigué agents and asked for help in sending "drug proceeds" to their "source of supply" in Mexico City. In reality, the recipients were undercover Mexican law enforcement officers, it added.

"The [US] undercover agents informed the authorized delegates that they did not want law enforcement to learn of the transactions, and that they preferred not to provide any form of identification or address information. When Sigué-authorized delegates requested some form of identification from the undercover agents, the agents produced multiple forms of identification cards, all in different names and bearing obviously different likenesses," the DPA states.

Some pass, many fail

In total, undercover federal officers conducted 84 successful transactions through 59 different Sigué agents, while 24 agents "properly refused" to conduct the illicit transactions, the DPA stated. It added that at 47 locations, the undercover officers and the Sigué agents "structured" the cash transactions by splitting large cash amounts over \$10,000 into several smaller amounts to avoid triggering currency transaction reporting thresholds at the Sigué corporate level.

The DPA also noted that the Sigué agents who conducted the transactions may be charged with money laundering under Title 18 USC Sections 1956 and 1957, as may Sigué, if it violates the terms of the agreement. It should be noted that the Financial Crimes Enforcement Network also assessed a \$12m civil money penalty against Sigué, claiming that its "failure to implement effective internal controls, training or independent testing to manage the risk of money laundering was serious, long-standing and systemic." FinCEN's penalty (PDF) will be satisfied by the \$15m forfeiture paid to the DoJ.

The identities of the Sigué agents snared by the sting operation are not revealed in court documents, although Sigué's general counsel, Robert Pargac, told Complinet that several have been indicted for money laundering and the DoJ has said it may indict others. He added that Sigué has terminated its relationship with around 20 of the agents accused of wrongdoing.

"We think that this is behind us now," Pargac said.

<http://www.complinet.com/global/news/news/article.html?ref=101562>

29/01/2008

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HSBC OCC 8875020



**Outlook bleak for many MSBs**

Sigue may have weathered the storm, but it remains to be seen whether its agents' alleged misdeeds will lead to more misery for fellow MSBs. In recent years, many MSBs have found themselves unable to find banks willing to serve them. The reason is clear. MSBs are high-risk customers and mitigating those risks is costly.

A case such as that against Sigue gives banks yet another reason to treat MSBs as pariahs.

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From: Michael F GREGG  
Sent: 18/02/2008 23:11 GMT  
To: Paul A THURSTON  
Cc: Richard E T BENNETT; Matthew J W KING; Stephen GREEN  
Subject: Re: CONFIDENTIAL - CNBV/FTU Meeting

Paul

This is most disturbing and we will need to have the most thorough of investigations.

[REDACTED]

[REDACTED]

Please keep me advised of all developments and can Matthew and David meet with me after GMB on Monday

Best wishes

Mike

HSBC Holdings plc  
Registered Office: 8 Canada Square, London E14 5HQ, United Kingdom  
Registered in England number 817987

Paul A THURSTON

Original Message

From: Paul A THURSTON  
Sent: 18/02/2008 16:49 CST  
To: Michael F GREGG  
Cc: Richard E T BENNETT; Matthew J W KING  
Subject: CONFIDENTIAL - CNBV/FTU Meeting

Mike,

I was asked to attend a meeting with the CNBV today [REDACTED]

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gs, Inc. HSB09340564  
HSBC OCC 8966014

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[REDACTED] The meeting included the Head of the CNBV (Dr Guillermo Babatz) and the Head of the Financial Intelligence Unit, FIU (Luis Urrutia), the financial crime unit of the Finance Ministry.

Guillermo Babatz referred to the previous discussions that had been held with HSBC on the issues of internal controls, which he knew we were progressing, and said that this meeting has been asked for because of additional issues that had been raised in the last two weeks by the Financial Intelligence Unit, that caused the CNBV to be even more concerned.

[REDACTED] The Head of the CNBV informed me that he considered these issues to be of sufficient significance that he would have to report them to the FSA, as our lead regulator.

He handed me a draft copy of the report that they had compiled which is in two parts:

1. A CNBV report on operational weakness in HSBC in many areas, including Frauds, Customer complaints, IT failures, Money Laundering processes, Culture, and Organisation structure that they had previously identified (and communicated in the previous meeting in October, which is summarised in my note below). The report now includes a summary of the actions taken by HSBC to address each of these, but they acknowledged that this was neither up to date nor comprehensive, and they asked me to review it and revert to them with a correct, up to date, picture on all the actions taken, so that they do not misrepresent the position.

2. A report from the FIU setting out at a high level the evidence that they have obtained that has raised their concerns on Money Laundering activities in HSBC, and that prompted them to report their concerns to the CNBV. The major points are:

- the high levels of US Banknotes exported by HSBC in 2005 and 2006 (considerably higher than any other bank)
- the high level of failure of HSBC to provide information requested by the FIU (considerably higher failure rate than other banks)
- missing documentation related to customers, not only for old accounts (which is a common failing across all banks), but of accounts opened since 2004, when new rules were introduced. They acknowledged the changes being put in place over recent months to improve account opening documentation in HSBC but said to me "What were the management of HSBC doing for the past 3 or 4 years?"
- the use of external legal firms to review information requests from the FIU, potentially risking breach of confidentiality on sensitive investigations - this practice is news to me, and to the local audit team, and will be investigated urgently.

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b) We will review all the points raised by the CNBV and FIU, check them out, and revert to them with a response setting out the actions that have been taken (or actions that will be taken, for the items which have only now been identified) so that they have a clearer picture of the progress that has been made.

c) The Head of Group Compliance will meet with them, following up on previous meetings that they have had with him, so that we can review the report and our response together, before they finalise any report to the FSA.

I have advised Richard Bennett, David Bagley and Matthew King, [REDACTED] Our security department investigator is meeting with FIU this afternoon to get the information from their case files that relates to suspicious internal activity, so we can commence an investigation of these. I have asked Internal Audit to assist in reviewing the other items raised (most of which came out of previous on-site inspections earlier last year, and are in process of resolution), and confirm the actions that have been taken. I am arranging for David Bagley to visit next week, when he and I can review our actions and response, and then he and I will meet jointly with the CNBV and FIU to follow up.

It is clear in this that our Head of Compliance is not as highly regarded by the CNBV as had been thought by local and Group management, and indeed appears to have misled us about the extent to which the CNBV have been informed of, and/or are satisfied with, our actions. This will need to be addressed urgently as well during David Bagley's visit.

I will provide a further update after the meeting next week, but if you need anything further in the meantime, please let me know. We will keep Richard Bennett and Matthew King updated, and I'm sure they will report on this to the Group Audit Committee next week.

Regards

Paul

----- Forwarded by Paul A THURSTON/HBMDX/HSBC on 18/02/2008 03:27 p.m. -----

Paul A THURSTON/HBMDX/HSBC 23/10/2007 02:18 a.m.

To: Michael F GEOGHEGAN/HGHQ/HSBC@HSBC  
cc:  
Subject: CNBV Inspection  
ct:

Mike,

At their request, I met today with the Head of Banking Supervision, and the Supervisor for HSBC, from our regulator, the CNBV, following their on site examination of various aspects of our business, including

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cards, money laundering and treasury operations. [REDACTED]

They walked me through a presentation pack which firstly set out specific points that had arisen during their inspection, but then moved on to more general concerns of the CNBV with HSBC in Mexico. These centred on:

- weaknesses in internal controls which they saw in several areas of HSBC, citing evidence of the level of credit card frauds, numbers of customer complaints to the bank and to the banking ombudsman, customer concerns that staff in branches do not have appropriate training and qualifications, frequency of IT failures, and slow progress in tackling KYC data problems and anti money laundering procedures.

- corporate culture, where they comment that since the purchase of Bitai, HSBC has driven growth in credit products and launched new products without adequate controls. They acknowledged the addition of new senior executives including the CFO and COO, and they welcomed these, but they are concerned that some areas of the business have not changed at all in mentality, or approach, despite the changing nature of the business, and some lower level staff have not been adequately trained to deal with the business now being undertaken. They implied that they considered that we were still running parts of the bank as if they were still Bitai, despite the new ownership and the change in business profile.

They also expressed concerns at senior management having dual responsibilities for Mexico and the region, stating that "there are many concerns on how management will be able to implement strong controls within the bank in Mexico, while keeping an eye on other countries".

Their final slide reads as follows:

#### \*REQUIREMENTS

As a result of the concerns pointed out, the CNBV needs the senior level commitment to solve the problems stressed. In order to do that, HSBC needs to set corrective programmes. These actions should include the following:

- set strong internal controls in key business and operational areas
- adopt measures to stop frauds, reduce clients's complaints and improve the level of service, to reduce reputational risk
- establish the necessary actions to improve IT performance and avoid technological risks caused by systems break down
- manage an effective culture of change
- avoid sharing senior officers responsibilities with LATAM
- set effective measures regarding money laundering issues
- avoid taking excessive credit risks in the credit card portfolio and set actions to assess this risk in an adequate manner\*

[REDACTED] They will issue a normal management letter in due course, without including some of the more sensitive areas, but they wanted to bring these to my personal attention to let

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me know of their concerns.

I indicated to them we were aware of these issues and were progressively tackling them. I advised them of the new appointments of an experienced Head of consumer risk with experience in Asia, who arrived a couple of weeks ago, and a new Head of card Fraud from GMO who arrived yesterday, the help we had sought from Ken Harvey to review the robustness of the IT operations and the planned internal audit of IT in November, and the major programme of customer file centralising and imaging which would give us more robust KYC data for anti-money laundering. I talked about the changes we are making to split Regional from Mexico responsibilities in areas such as CIBM, IT, Risk and Audit, but they advised that their specific concern here was with PFS, and I indicated that they could also expect changes in this area in the near future.

I said that we were embarked on changing the business models of the bank, and bringing in specialist expertise, but that culture change would not happen over night. However, I believed that the infusion of new management, combined with changes we were planning to incentive schemes to put more emphasis on customer satisfaction and business quality would help push the bank in the new direction. I commented that we have a young staff, and while they lacked experience, I was confident that if we were clear in our business direction to them, and gave them appropriate training, and measures, we could make real progress.

I told them that I welcomed their coming to see me, and that we would respond positively to the management letter, when it arrives, and that I would also meet up with them again to update them on progress with the issues not covered in the management letter.

They indicated that this was what they wanted to hear, and that they would report back positively to Guillermo Babatz, the Head of the CNBV.

I took the opportunity to remind them of the issues that I had raised with them and Babatz two months ago on the PTU (profit sharing tax), where Bancomer and Banamex had been allowed to take action to avoid payment, and they acknowledged that we would also have to take action if we were to remain competitive, and they indicated that while they didn't like it, they would not object provided that our solution was within the existing laws and regulations.

I will follow up on all of these points, but thought that you should be aware.

Regards

Paul

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From: Paul A THURSTON  
 Sent: Fri Mar 07 21:43:28 2008  
 To: David W J BAGLEY  
 Cc: John R RENDALL  
 Subject: Re: HBMX  
 Importance: Normal  
 Attachments: image\_0.gif; MEETING ATTENDANCE NOTE - HBMX - Leopoldo - Apr08.doc

David/John,

The comments made by Leopoldo are quite concerning, and it would appear that he was more aware of the weaknesses, and the concerns of the CNBV, than Ramon has indicated. To me, the jury is still out on Ramon, and we need to have a discussion between the three of us, pretty soon, about the whole question of structuring the regional and Mexican CMP responsibilities.

Regards

Paul

David W J BAGLEY/HGHO/HSBC

David W J BAGLEY/HGHO/HSBC Sent by: Marion O ROACH To: Paul A THURSTON/HBXM/HSBC@HSBC  
 07/03/2008 08:42 a.m. cc: John R RENDALL/HBXM/HSBC@HSBC  
 Subject: HBMX  
 cl

Paul

You will recall that I carried out an exit interview with Leopoldo Rodriguez Borrero. I attach a copy of the file note that I dictated during my visit and which has now been typed up.

As I hope time will have allowed, I intend discussing the content of my conversation with Leopoldo with John Rendall with a view to:-

Regards

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David Bagley

P.S. Both actions followed up and I believe these to be closed.



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HSBC OCC 8874823

MEETING ATTENDANCE NOTE – 27<sup>th</sup> February 2008

Attendees: Leopoldo Rodriguez Borroso (LRB)  
David Bagley

Key points raised by LRB in an exit meeting were:-

1. He had asked to move from the AML job principally due to fears with regard to his own personal civil and criminal litigation exposure, the risk to his physical security, the fact that he did not think that the job was suitably graded or paid and because he had already made it clear when he originally took the job that this would be a short-term post not long term.
2. LRB went on to explain in some detail that his perception of exposure to criminal sanctions was due to the continued poor controls in the bank, the fact that there were allegations of 60% to 70% of laundered proceeds in Mexico went through HBMX and because he did not think that senior management had any commitment to robust AML controls. He thought it was only a matter of time before the bank faced criminal sanctions and cited a number of cases, including [REDACTED] as examples of the bank's involvement in activities which might lead to the bank being sanctioned directly and him and members of the team being sanctioned personally.
3. It was clear that LRB felt very strongly that relevant business heads within HBMX had absolutely no respect for AML controls and the risks to which the Group was exposed and had no intention of applying sensible or appropriate approaches. Again he cited a number of examples where despite strong recommendations with the CMP business heads had failed or refused to close accounts or indeed on occasions file SARs. He thought that there was a culture that pursuing profit and targets at all costs and in fact had seen no recent improvement in the standard of controls or the types of decisions being taken.
4. He was critical of the level of resources in his team and felt that his team had done much to keep the bank out of trouble by working extra hours against impossible deadlines and handling significant volumes of alerts including those from CAMP. A figure of some 14,000 per month/per annum? was cited.
5. When asked, LRB indicated that he thought he needed at least 35 new headcount.
6. LRB was sceptical about the ability or likelihood of being able to migrate processes to GSC's at least while the bank's systems were so immature (how could anybody check on-line and validate transactions) but thought that this might be a medium term solution once bank systems improved.
7. It was clear that LRB felt extremely strongly about his treatment and was resentful both with regard to his recent performance rating, the fact that he thought that the AML department was being scapegoated, and was disbelieving that the bank could find no alternative role. On balance, however, he accepted that he was a difficult individual, had perhaps on occasions been tactless and again

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thought that he would prefer to leave even though he was likely to suffer economic hardship rather than stay in a job where he felt personally exposed.

8. He was adamant that David Leighton had promised him that if he did the job for ten months he would be looked after and felt that this commitment had been reneged upon. LRB was extremely critical of RG who he described as being indecisive, weak and desperate to retain his job and lacking any understanding of AML matters. There was a detailed discussion about the operation of the MLD committee chaired by RG where LRB indicated that he thought it would be chaired by John Rendall. Again he felt there had been little improvement in the decision-making within this Committee.
9. LRB was sceptical as to whether the bank would be given an extension of time within which to retrospectively remediate high-risk customers and said why should the authorities given any further extension given that the bank had previously failed to meet earlier commitments. He was clearly of the view that the bank was heading to a situation where in due course it would be sanctioned or penalised and had seen nothing in recent months or weeks which suggested to him that matters could improve.
10. LRB then referred to a report he had been in the process of writing which would set out and articulate all of the various areas of weakness that he thought existed. This report had not been finished by him and he was still deciding whether he would write it. DB said that this was very much a matter for L to decide upon personally and that DB would neither encourage him to write it, nor discourage him from doing so. It was very much his own personal decision. Having said this, DB indicated to him that if the report was produced and sent to DB he would discharge his own personal obligations in his current role by causing the report to be carefully considered and factored into any wide work or other review that was being undertaken. DB would not just ignore it or bury it but equally would have to balance views expressed by LRB against views expressed by others and form a view. On balance, it seemed likely that LRB will submit such a report.
11. LRB asked that his team members, particularly the more senior members be looked after and no in any way penalised for his departure. This was genuinely unselfish. DB assured him that he would do what he can in this regard.
12. Overall, LRB gave the impression as having been dedicated and committed to his work, having real and genuinely felt concerned. His opinions were very firm, the conversation extremely cordial but at no stage were there any suggestions that he felt that individuals, including individuals within CMP were in any way compromised other than perhaps by reason of incompetence or poor management. He clearly feels badly treated but accepts that some of the consequences have been brought on by himself not least asking to be moved.

From: John F ROOT  
 Sent: Wed Jul 30 21:48:30 2008  
 To: David W J BAGLEY; Warren G LEAMING; Susan A WRIGHT  
 Subject: HBMX Visit Update  
 Importance: Normal

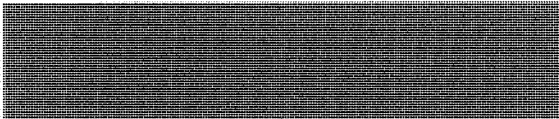
It has been an extremely productive trip. Below please find a summary of what I have discovered so far:

#### USD Cayman Accounts

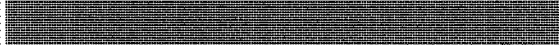
There are 35,000 accounts with a monthly total average of USD 400 million. Many of these accounts were opened by Bilal through its New York branch. When this branch was closed, the accounts were transferred to the Cayman branch, which was opened in 1980.

The real surprise was the existence of an HBMX audit in January 2008 on KYC for the USD Cayman accounts. It is not clear who in AML responded, and how. Blank looks all around. I should know more in a few hours.

The report, which is in Spanish, concluded that KYC control was "below standard". A sampling showed that 15% of the customers did not even have a file. For the files that could be found, there were serious failures in following Group procedures.



Earlier this year, HBMX was found to be in violation of USFC rules for having advertised the services. The account was not subject to normal review; however, there is a check on the account. The account was not subject to normal review; however, there is a check on the account.



CEO Luis Pena has stopped all new Cayman accounts. CNBV were said to be a bit surprised at this, and not entirely happy that a source of USD was being foreclosed.

As for the existing accounts, the management plan is to offer to clients to transfer them to another Group entity, currently envisaged to be HSUS (although an actual Cayman entity was also briefly contemplated).

Fixing the Cayman accounts will be a struggle. How do you locate clients when there is no file?

#### High-Risk Transactions

Since the beginning of the year, [REDACTED] a sub-director in AML, has identified 1,100 high-risk accounts. Of these, 270 have been cancelled, most with SARs. These high-risk accounts include USD Cayman

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accounts. [REDACTED] says that his team is under-staffed and that there is little or no accountability in high-risk regions for managers who knowingly accept suspect clients. The main area of concern is PFS, according to [REDACTED] even at the "highest" levels. (Yes, I asked.) A [REDACTED] veteran of Bitai, and close to retirement, [REDACTED] was alarmed at the gap between what we say about integrity and proper AML controls, and what is actually happening out in the field, particularly in states close to the US border. His misgivings should of course be treated confidentially. I don't want my sources fired or killed. (No exaggeration here – more people are dying in the drug wars in the north of the country than are being killed in Afghanistan or Iraq.)

John Rendall has asked Ramon Garcia to determine what products have a high AML risk. The COO has also asked Ramon to look at USD remittances to assess client risk. (HBMX is the largest remitter in Mexico of dollars back to the States.) High-volume customers will be reviewed and risk-weighted. Ramon will shortly give John Rendall target dates for these reviews.

#### AML Staffing

[REDACTED] now working in AML on a 50-50 basis with PIF under [REDACTED]. This seems currently acceptable as his AML team has not yet been formed, and there is some overlap in the investigations. [REDACTED] has put together a business plan for 14 FTE including himself and an AOP of USD 500k. The plan may not be accepted in its current form because of cost-cutting at HBMX (all departments to cut 15% of headcount and budget). It might be a good idea for one of you, and perhaps also Matthew King, to stress as soon as possible with Luis Pene the importance of adequate AML staff. I have already done so with John Rendall, who generally agrees with me, but wants more specifics about the plan. (One reservation is that AML seems a bit top-heavy in management.)

There is a major issue with staffing. HR and [REDACTED]

[REDACTED] My own view is that we need to convince HR and LGA to let us run our own department, which means contracting our own staff. If local laws require us to pay redundancy packages, so be it. There is no management control where we cannot choose the right people. For example, the AML sub-director responsible for CAMP monitoring, [REDACTED] has clearly failed in his task with 12,000 alerts a month, the department has a backlog of 30,000 alerts. In other words, they are almost three months behind.

[REDACTED] It is clear, however, that both sub-directors, [REDACTED] should be fired for poor performance. Ramon agrees and he says he will press the matter with John Rendall. Ramon and I want to replace [REDACTED] with [REDACTED] who is highly thought of by senior managers here.

Having already met with [REDACTED] I will meet later today with the HR person responsible for Compliance, [REDACTED], to discuss how our needs can be better met.

\*Restauracion\* Project

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Much progress has been made. John Rendall and the team have worked very hard, with concrete results to show for it. I attended a lengthy meeting of the project last night and came away very impressed with what they have achieved. I will forward a number of useful reports to you on the current situation. Audit think that much more can and should be done, but the COO and his team have the proper risk-based approach.

#### Reporting

██████████ is extremely busy, with meetings to attend every day and many reports to write. I have agreed with him that I will liaise regularly with ██████████ for the reports we require so as to ease the burden on him. ██████████ and I have discussed the new reporting template and how we should proceed.

#### Operating Loss in Colombia

A recent mishap in Colombia illustrates what we are up against in the region.

Our treasury in Colombia sold rather than bought repos, and ended up with no securities with the Central Bank to support the sale. We expect a "penalty not a fine", which would appear to be a distinction without a difference. The current estimate is USD 580k. The key issue, according to Graham Thomson, is that someone in Colombia signed off on their being FIM-compliant when they weren't. He is investigating this point, and also why he was only informed last Friday when the problem came to light two weeks ago.

The same concerns for Colombia, e.g. FIM compliance, apply of course to Central America. Key managers are telling us that they are following Group procedures when, in many cases, they aren't.

John Root  
30JUL08

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From: John F ROOT  
 Sent: Tue Aug 05 08:35:12 2008  
 To: David W J BAGLEY  
 Subject: Re: Fw: HBMX - CAYMAN ACCOUNTS  
 Importance: Normal  
 Attachments: Doc Link.htm

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David W J BAGLEY--05/08/2008 08:09:06--Graham, We will on the basis of this just work on the assumption that nothing has been done to date. I do find it surprising.

David W J BAGLEY/GMO/HSBC 05 Aug 2008  
 08:08 Phone no. 7991 8545  
 44 20 7991 8545 Mail Size: 23484

To: Graham THOMSON/HBMX/HSBC@HSBC  
 cc  
 Subject: Fw: HBMX - CAYMAN ACCOUNTS  
 ct  
 Entity

Graham,

We will on the basis of this just work on the assumption that nothing has been done to date. I do find it surprising that there can have been no response and yet the audit was closed out. Is this a breach or are you in audit becoming softer.

Regards

Forwarded by David W J BAGLEY/GMO/HSBC on 05/08/2008 08:08

Matthew J W KING/GOM/INA  
 GHQ/KH/HSBC Sent by: Liz A  
 TESTER/MGR/INA GHQ/KH/HSBC 05 Aug  
 2008 07:12 Phone no. 799 21178  
 44 0 20 799 21178 Mail Size: 26467

To: David W J BAGLEY/GMO/HSBC@HSBC  
 cc  
 Subject: Re: Fw: HBMX - CAYMAN ACCOUNTS  
 ct  
 Entity

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Graham THOMSON/HBMX/HSBC

Graham THOMSON/HBMX/HSBC HBMX  
04/08/2008 23:19 Mail Size: 13610

To: Matthew J W KING/GGM INA GHQ/HGHQ/HSBC  
cc: Alfredo BOLANOS/HBMX/HSBC@HSBC,  
Chris.R.BENTLEY@hsbc.com.mx  
Subject: Re: Fw: HBMX - CAYMAN ACCOUNTS  
Entity: HSBC Holdings plc - HGHQ

Matthew

I refer to our recent emails.

I am now received further clarification from GAQ on the audit report recommendation status.

No response was received following the issue of the report in APR08 and its recommendations were "closed off" in AIS and included in the matrix of branch control weaknesses, which GAQ routinely discusses with the business.

Periodically GAQ reports on management's progress on these items and continues to check on compliance standards as part of its regular branch audits, where as you aware from reports to audit committees etc, branch standards have failed until recently to be improved. Project Restauracion is now rectifying that position and has included the higher risk CI customer accounts in its risk based remediation approach. HBMX CEO has suspended the provision of CI accounts to new customers.

Regards

Graham Thomson  
Head of Group Audit Latin America & the Caribbean  
Tel (52) 55 5721 6236

Matthew J W KING/GGM INA GHQ/HGHQ/HSBC

Matthew J W KING/GGM INA  
GHQ/HGHQ/HSBC 31/07/2008 11:44 a.m.

To: Graham THOMSON/HBMX/HSBC@HSBC  
cc:  
Subject: Re: Fw: HBMX - CAYMAN ACCOUNTS  
Entity:

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.

HSBC OCC 8874830



Graham,

What is the position with the audit report? Was it sent to me under standing instructions? How many of the recommendations remain outstanding and are these included in the reported stats?

Regards

Matthew

Graham THOMSON/HBMX/HSBC

Graham THOMSON/HBMX/HSBC HBMX  
31/07/2008 17:38 Mail Size: 11613

To: Emilson ALONSO@hsbc.com.mx  
cc: Andy GENT/HBMX/HSBC@HSBC, David W J BAGLEY/GMO/HBSC@HSBC, Luis PENA KEGEL/HBMX/HSBC@HSBC, Ramon GARCIA@hsbc.com.mx, Matthew J W KING/GGM INA GHQ/HGHQ/HSBC  
Subject: Re: Fw: HBMX - CAYMAN ACCOUNTS  
Entity: HSBC Holdings plc - HGHQ

Emlison

I first became aware of a Cayman issue on Monday (28th) at LAM RAC when CMP reported that a fine of USD 50 k had been levied on HBMX. On Tuesday I asked for a copy of the incident report CMP had sent to GMO. A response is pending. I have chased again this morning. I shall advise further once I have received a copy of the report.

Regards

Graham Thomson  
Head of Group Audit Latin America & the Caribbean  
Tel (52) 55 5721 6235

Emlison ALONSO/HBMX/HSBC

Emlison ALONSO/HBMX/HSBC 31/07/2008  
11:08 a.m.

To: Luis PENA KEGEL/HBMX/HSBC@HSBC, Andy GENT/HBMX/HSBC@HSBC, Graham THOMSON/HBMX/HSBC@HSBC

cc: David W J BAGLEY/GMOMHSBC@HSBC

Subject: Fw: HBMX - CAYMAN ACCOUNTS

Gentlemen,

Can you put me aware about this particular problem, which I am not aware of?  
 Erlson

Forwarded by Erlson ALONSO/HBMX/HSBC on 31/07/2009 11:06 a.m.

David W J BAGLEY/GMOMHSBC Sent by:  
 Marion O ROACH/HQHQ/HSBC 31 Jul 2008  
 03:48 a.m. Phone no. 7691 8645 Mail Size:  
 5742

To: Richard E T BENNETT/HBHM/HSBC@HSBC  
 cc: Michael F GEOGHEGAN/HQHQ/HSBC@HSBC, Erlson  
 ALONSO/HBMX/HSBC@HSBC, Matthew J W KING/GGM INA  
 HQHQ/HQHQ/HSBC@HSBC, John R  
 RENDALL/HBMX/HSBC@HSBC, Luis PENA  
 KEGEL/HBMX/HSBC@HSBC  
 Subject: HBMX - CAYMAN ACCOUNTS  
 Entity:

Richard

We have been in discussions with HBMX CMP with regard to certain potentially suspicious transactions identified by routine transaction monitoring. This initial report has widened into a more general issue as detailed below. Whilst we continue to follow up with HBMX, I think it is appropriate to provide an initial report as follows:

I am awaiting further details of the suspicious activity identified, but in brief it appears that our CAMP monitoring system identified significant USD remittances being made by a number of customers to a US company alleged to have been involved in the supply of aircraft to drugs cartels. Appropriate reports have been filed and have apparently enabled the authorities to identify significant related activity passing through other banks. This led to a review of the way in which HBMX operates USD-denominated accounts through its Cayman branch.

HBMX holds a Category B banking licence in Cayman which allows them to provide banking services anywhere other than to Cayman residents.

The licence, inherited from Bital, allows HBMX to provide USD-denominated services to persons domiciled in Mexico. Mexican regulation apparently prohibits individual Mexicans (i.e. non-corporate) to hold USD-denominated deposit accounts in Mexico. The branch currently holds USD400m and 35,000 accounts. There is no physical presence in Cayman and effectively front and back office services are provided on the ground in Mexico. Although HBMX were recently fined USD50,000 for the inappropriate provision of these services in Mexico, I am advised that CNBV are aware of the existence of the accounts and services and have raised no concerns. HBMX are however sensibly reviewing the position. I have also asked CMP to review whether there are any similar operations in LATAM.

There continues to be a real focus on the level of USD-denominated activity in Mexico by CNBV and other bodies, and the extent of HBMX's activity in this area. This account base has to therefore be seen as high-risk from an AML and reputational perspective.

Apparently an audit carried out in 2006 of the Cayman branch activities was rated as below standard and identified significant KYC weaknesses. It will be important to ensure that these accounts will be covered by the various account remediation processes underway in HBMX, and as a priority area. As a precaution HBMX have issued instructions that no new accounts be opened pending a review of these activities. We are also checking whether any similar activities exist in LATAM.

I will report further in due course, but thought it important to provide preliminary reports.

Regards

David Bagley

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HSBC OCC 8874833

From: John F ROOT  
 Sent: Fri Sep 12 15:14:17 2008  
 To: Adrian CRISTIANI  
 Cc: David W J BAGLEY; Warren G LEAMING; Susan A WRIGHT  
 Subject: Fw: Cayman Accounts  
 Importance: Normal  
 Attachments: image\_0.gif; Doc Link.htm

Adrian,

At Warren Leaming's request, below please find a recent breakdown of the USD Cayman accounts at HBMX (i.e. held by a branch of HBMX with a "Category B" offshore Cayman license but no physical presence or client documentation in Cayman).

The HBMX "Restoration" project chaired by John Rendall, HBMX COO, is endeavouring to regularise these accounts on a risk-basis. Account opening documentation is generally poor or non-existent and there is a lot of work to do. Money-laundering risk is consequently high.

Regards,

John Root

----- Forwarded by John F ROOT@GMO@HSBC on 12/09/2008 15:05 -----

Ramon GARCIA/HBMX/HSBC@HSBC04 Sep 12 2008 15:04 Mail Size: 37281

To: John F ROOT@GMO@HSBC@HSB  
 cc: Maria SALAZAR/HBMX/HSBC@p  
 Subject: Re: Cayman Accounts  
 Entity

John,

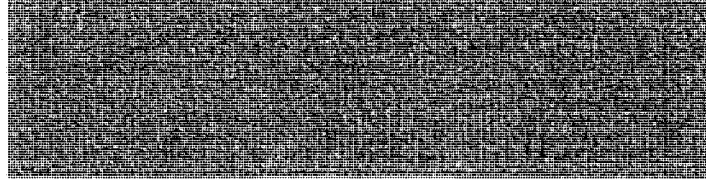
Please find attached information requested. Regards, Ramon

CAYMAN ACCOUNTS

Permanent Subcommittee on Investigations  
 EXHIBIT #33

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HSBC OCC 8876784



Customers were classified in emergency lights considering their transactional behaviour as follows:

RED SSC status, black lists and customers with one or more reports to the authority (SARs) were considered.  
YELLOW Customers alerted by CAMP system without SARs  
WHITE Customers with no coincidences in the two previous ranges.

John F ROOT/GMO/HSBC@HSBC

John F ROOT/GMO/HSBC@HSBC 11/09/2008 06:51 a.m.

To Ramon GARCIA/HBMX/HSBC@h

cc

Subject: Cayman Accounts

ct

Ramon,

Could you please send me figures for the Cayman Accounts? How many? Total? SARs filed? CD? Etc.  
Etc.

Regards,

John

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CUSTOMERS		BALANCE AS OF 3/31/08	
WHITE	27,725		\$1,852,250,721.81
YELLOW	39,548		\$4,385,506,547.14
AND TOTAL	67,273		\$6,237,757,268.95

CUSTOMERS		ACCOUNTS		BALANCE AS OF 3/31/08		CUSTOMERS		ACCOUNTS	
WHITE	1,214	2,743		\$355,833,722.83	2.85%	WHITE	1,214	2,743	3.84%
YELLOW	2,027	2,854		\$180,481,548.39	4.98%	YELLOW	2,027	2,854	3.98%
AND TOTAL	45,241	5,597		\$536,315,271.22	93.31%	AND TOTAL	45,241	5,597	92.88%

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Redacted by the Permanent  
Subcommittee on Investigations

From: [REDACTED]  
Sent: Thu Nov 27 02:38:42 2008  
To: Jaime J SAENZ; Ramon GARCIA  
Cc: [REDACTED]  
Subject: Seriously consider restricting the product Dollars accounts in the zona frontera Product 63  
Cuenta Maestra en Dolares P.F.  
Importance: Normal

Jaime y Ramon,

In the same way we have already restricted new Caiman Island accounts from opening, due to the massive misuse of them by organised crime, I think it is about time we seriously consider recommending to the business, that we can not support their management of Dollars accounts in the zona frontera Product 63 Cuenta Maestra en Dolares Personas Fisicas.

We have suffered three cases this week where dollars accounts based in the zona frontera have been opened with the apparent sole intention of using them for money laundering.

The pattern is as follows:

1) Accounts are opened at various branches in Cd Juarez (or other border areas within 20km of the USA) in dollars product number 63.

2) Declarations are made by the customer in their branch KYC questions of low account movement per month (in one case the client indicated he was going to move USD300 a month, but in fact moved USD1.4Mn!!!!)

3) Cash is then deposited in branches far from the border (Toluca and Edo de Mexico.) The individual deposits are normally USD50K but it is one customer, standing at one cashiers window, depositing ten to twenty bundles of USD50K. The total is USD500K to USD933K in one customer transaction (albeit separated into 20 bundles)

So far the total of this cash has surpassed USD3Mn in two weeks. These are the accounts we have been notified about, but I imagine that there will be many more in the coming weeks/months.

There are very apparent breaches of procedures in both the branches that opened the accounts, and the branches that are receiving the funds. (Please see below)

It is my belief that the professional money launderers have got wise to our procedures, and are now going to "hit and run" us. They will open accounts, use them to launder as much money as possible, in a short a time as possible, and then either close the account themselves, or wait for our procedures to do it.

The normal time scale in a typical case, to close an account is three months, from when the first CAMP/ROI alert comes in to the AML area. As you know it is then passed via the CCC to UCE who then have to locate the file, and provide it to LGA for them to start their process. LGA say they take on average it is 30 days, but with the restoration project, their backlog is now almost 2.5K cases.

In another case I am working on, the client has already been notified by LGA that the account is going to

Permanent Subcommittee on Investigations

EXHIBIT #34

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HSBC OCC 8875736



be closed, and he is using his last two weeks to move as much money as possible. So far this is USD1Mn in three days, to add the the USD9Mn that he has successfully laundered in the last three months.

It is my opinion that we are not "Preventing" anything. We are allowing the organised criminals to launder their money, and only after three months do we final manage to stop them (by closing the account). By which time they have probably opened up another dollars account in a fake name, and started the whole process again.

The first essential thing that *must be done* is a bank wide email explaining in clear and simple terms the cash deposit amounts that are laid down in CMP PLD 050003.

In my investigation so far, **NOT ONE SINGLE PERSON** has heard of this circular, and no one is following it.

It is my opinion that until PFS can properly educate their staff in the correct procedures for dealings with these types of accounts, then the account should be removed from our list of products.

If we were rigourously sticking to this procedures, then I am confident that we would seriously restrict the flow of dollars into our organisation. I am aware that this is a theme that has been raised by Luis Peña and the CNBV.

For your information the part that I consider most relevant of CMP PLD 050003 is below:

*4. Operaciones en efectivo con dólares de los Estados Unidos de América*

*Queda estrictamente prohibida la realización de las siguientes operaciones:*

*Entrada de Giros Bancarios*

*Compra venta de cheques de viajero a no clientes/asusarios*

*Venta de Cheques de Caja a usuarios.*

*HSBC ha establecido el siguiente mecanismo de escalamiento de aprobación interna para el trámite de operaciones (depósitos y retiradas) en efectivo con dólares de los Estados Unidos de América:*

*Nivel del Funcionario Facultado*

*Ejecutivo de Cuenta (PFS)*

*Líder de Unidad de Negocio (PFS) o Ejecutivo de Cuenta (tratándose de otras Segmentos)*

*Subdirector (todos los Segmentos)*

*Director (todos los Segmentos)*

*Director Ejecutivo (todos los Segmentos)*

*No se requerirá aprobación en el trámite de operaciones en efectivo con dólares de los Estados Unidos de América que realicen personas físicas, por montos inferiores a los 10,000.00 dólares, así como de aquellas que lleven a cabo personas morales, por montos inferiores a los 50,000.00 dólares.*

We have had clients deposit USD933K in one day in one branch. This deposit should have been approved by the D.Ejec , but it has never reached him. Nor it appears have any of the smaller deposits reached even the levels of Sub-Directors!

It needs to be made clear that any branch receiving more than USD100K total with one customer (regardless of how the customer wants to separate the deposits) that has not notified their Sub-Director , will be subject to Zero tolerance policy enforced by UCE and the Sub-Director, who should have been told .

This matter is not Fraud so PIF resources need not be used, and it is not necessary to involve AML in every case as the evidence is very obvious, and easy to prove through branch cash movements. Of course the same Zero tolerance should apply when the cash deposit indicates Directors and D.Ejec need to be informed.

PFS Channels and Products should be able to "police" themselves in this matter, and I repeat that if we stick to these procedures the money launderers will quickly become very tired of waiting to get authorization from our senior management, and will carry out their business in another financial institution.

I greatly appreciate that this is a complicated issue, but without firm and decisive action we will never stop ourselves being used by organized criminals.

Thanks and regards,



— = Redacted by the Permanent Subcommittee on Investigations

From: David W J BAGLEY  
 Sent: Thu Nov 27 08:24:53 2008  
 To: Warren G LEAMING  
 Cc: Richard E T BENNETT  
 Subject: Re: Mexico  
 Importance: Normal

Warren

Thank you and all noted.

What I find most frustrating is the way in which new issues constantly emerge however much time is spent with HBMX.

The practice of changing USD in the branches presumably with little or no ID for non customers is in breach of Group policy. When looking at our USD exposure how can this have been missed.

The SAR filing is just daft as is allowing an account to operate pre-closing and taking too long to close. Are you able to challenge the involvement of legal in this process. If not subject to Richard's views can they gear up their effort in this area.

Regards

\*\*\*\*\*

HSBC Holdings plc  
 Registered Office: 8 Canada Square, London E14 5HQ, United Kingdom  
 Registered in England number 617987

\*\*\*\*\*

Warren G LEAMING

----- Original Message -----

From: Warren G LEAMING  
 Sent: 27/11/2008 01:29 GMT  
 To: David W J BAGLEY  
 Cc: Richard E T BENNETT  
 Subject: Re: Mexico

David/Richard

Mike Geoghegan today visited the president of the CNBV Guillermo Babatz with Luis Pena HBMX CEO

Permanent Subcommittee on Investigations

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HSBC OCC 8875605

and Emilson Alonso. It was anticipated that during the discussion the Banks controls on AML would arise following Paul Thurston's meeting CNBV in March. Ramon and I contributed to a briefing paper for Luis / Mike which is attached. We had anticipated that the CNBV would be comfortable with the improvements that had been made with the controls but that they may still be concerned with the actions of the Bank's staff in accepting deposits without apparent KYC/ due diligence (ie has the message penetrated down to the rank and file).

At the meeting apparently Mike acknowledged the CNBV may be concerned around the Banks controls on AML. The CNBV president, who was accompanied by Patricio Bustamante (supervision) and Pablo Gomez (AML) noted that significant progress had been made to the Banks controls but they remained very concern in respect of:

1. The USD Cayman accounts and the slow speed of remediation
2. The sheer volume of US Dollars that HBMX repatriates / exports

Between January and September HBMX repatriated USD 3b, 38% of the market which is double Banamex USD 1.3 b which constitutes 17 % of the market and yet Banamex is the biggest Bank in Mexico and HSBC is 5th largest. The authorities are concerned that when-ever there is a serious MLD scheme HSBC seems to be involved. CNBV also worried that the USA authorities are concerned at the very high levels.

Apparently Mike told Luis that he is not holding him responsible because he is new but directed him to sort the problem out. When Luis said this could result in lost profits of many billions Mikes clear response is that nothing is worth risk to our reputation.

Luis called a task force meeting this afternoon that Ramon attended. During this meeting it became clear that we are very good at buying/acquiring dollars but we do not seem to sell them and hence our very high repatriation figures. 80% of our dollars come from money exchange business at branches, there is no limit on the amount of dollars that costumers can convert to pesos and for non customers we convert up to 3000 dollars, and do not require any KYC.

Luis has decided that draconian measures are required and he is proposing

1. The current freeze on opening USD Cayman accounts will continue indefinitely (there were proposals to reopen as early next week). In addition no new cash deposits will be accepted to the existing accounts.
2. HBMX will cease to buy, accept, sell US cash for all customers.
3. all remediation must be completed by 31 January (earlier than planned March)

Business are reviewing how to implement and will meet again on Friday morning.

In the 2 days I been here it has become apparent that

1. While remediation efforts have progressed they have in some instants been very slow, particularly around phase II corporate accounts. In addition there appears to be a huge back-log in closing accounts as this is a legal process managed by legal. Pending closure customers can continue to operate their accounts which may be part of the reasons for multiple SARS. Jaime's team is producing figures but there are reports of accounts that MLD committee ordered closed in March continuing to operate.
2. how to resolve Accounts with multiple SARS not being closed in breach GPP 25. It seems that SARS are filed before we have complete information as to whether there is a need to file them in order to comply with local regulation. We are also reviewing the practice of Director Generals being able to sign-off accounts that can remain open.

3. We are reviewing the criteria for high (red) medium (yellow) low (white) customer risk profiles.

Obviously this will evolve over the next few days. Mikes visit and Luis proposed actions are considered extremely sensitive here in Mexico and local management want to get their ducks in a row before advising GMO formally so it will be much appreciated if the above could not be treated as information only and not disseminated without discussing further.

Best regards

Warren

[attachment "CEO Restauración Script.doc" deleted by David W J BAGLEY/GMO/HSBC]

David W J BAGLEY--26/11/2008 22:52:21--Richard I was at the legal awards dinner where I note you were a judge. During this I took a call from Warren where because of

David W J BAGLEY/GMO/HSBC Nov 26 2008  
22:52 Mail Size: 2181

To: Richard E T BENNETT/HSBM/HSBC  
cc: Warren G LEAMING/RLA LGA MEM/HSBM/HSBC  
Subject: Mexico  
Entity

Richard

I was at the legal awards dinner where I note you were a judge. During this I took a call from Warren where because of where I was I could not prolong. Core was however that at MFC's meeting with CIBV they raised concerns re the Cayman accounts and amount of USD going to US from HSMX. Am catching up with Warren in the morning.

Regards

\*\*\*\*\*

HSBC Holdings plc  
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Registered in England number 817987

\*\*\*\*\*

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HSBC OCC 8875607

From: Warren G LEAMING  
 Sent: Mon Dec 08 14:01:30 2008  
 To: Ramon GARCIA; John R RENDALL  
 Cc: John F ROOT; Susan A WRIGHT; Catherine BUSSERY; David W J BAGLEY; Andy GENT  
 Subject: Mexico Visit  
 Importance: Normal

Ramon/John,

Please find attached the draft email setting out my high level thoughts following my recent visit. Could I please thank you both for the time that you took to spend with me during my visit during what was a very busy and turbulent time for you both. It was of considerable value in clarifying many of the current issues in Mexico and Central America and I hope that I added value in respect of my discussions with those on the ground.

Despite the reservations expressed by the CNBV in respect of the quantity of US dollars repatriated and progress of remediation, I was heartened to note that they also acknowledged the significant progress that has been made in respect of the compliance and AML controls over the past twelve months and since the CNBV meeting with Paul Thurstion in March. If you feel that I have neglected to mention something or you have any issues with my conclusions expressed in my draft note please let me know. I intend to send the note to Luis Pena by Friday, 12 December.

Regards,

Warren

DRAFT EMAIL TO LUIS PENA

Luis,

As you know I visited HBMX between Tuesday 25th November and Friday 28th November. I spent my time with the Compliance and AML team in Mexico and thought that I would offer the following thoughts/conclusions as a result of my discussions.

Submission of SARs within 30 days. Currently local regulation requires that if suspicious activity is recognised that a SAR should be filed within 30 days. It is apparent that in many instances the business are not providing the information required to the Compliance department to determine whether a SAR should be submitted or not within the 30 day period. Given the regulatory requirement and the absence of appropriate information in order to come to an appropriate conclusion, SARs are being submitted when the information is subsequently received it is not possible to retract the SAR even if the information reveals that it was not appropriate to submit the SAR. Accordingly the numbers of SARs that are being submitted may well be too high and given the GPP25 requires that accounts be considered for closure after two SARs are submitted, we may well be closing accounts where there is no need to do so. This is both unfair on our customers and causes increased work. I note that the regulation is to be extended to 60 days, having said that pressure should be brought to bear on the business to ensure that appropriate information is submitted to Compliance in time for them to come to a conclusion and submit SARs within 30 days.

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HSBC-PSI-PROD-0197874

EXHIBIT #36

Closure of accounts - backlog and blocking. When accounts are to be closed, either as a result of the remediation programme or as a result of a direction by the CCC committee, policy in HBMX requires that such accounts be sent to Legal who will instruct an attorney. Apparently the law requires that customers be appropriately notified. It is apparent that there is a significant backlog (3,659) of accounts to be closed. Of this amount 675 accounts pending closure were ordered to be closed by the CCC on suspicion that they are used for money laundering activity. You will note that some of these accounts are very old, in fact it appears that there are 16 accounts that were sent for closure in 2005, 130 from 2006, 172 from 2007 and 309 from 2008 that remain open. I am advised that based on legal advice it is not possible to block the accounts before closure and accordingly all of these accounts remain open with transactions being conducted on them which also increases the number of subsequent SARs being submitted to authorities. I would ask that the legal advice be reviewed and if appropriate a commercial decision be taken because I was advised that Scotiabank do not use attorneys or their Legal department but notify customers using certified mail. I have also reviewed translations of the applicable legislation which appears to confirm this. High profile accounts that Public Affairs have advised should not be closed because of reputational sensitivities should be reviewed at DGA level to ensure appropriate remediation and/or closure.

GPP25 - DGA letters. This Group policy requires that if two SARs are submitted the account should be considered for closure. HBMX policy allows the account to remain open if there is a DGA letter. There are a large number of DGA letters and I am not necessarily confident that appropriate due diligence is done by the business before such letters are submitted. You will recall that historically there have been two very significant cases [REDACTED] where Compliance recommended that the accounts be closed and that the business had taken a commercial decision and insisted that they remain open. Subsequent events have revealed that these cases involved blatant and systematic AML which has caused the Bank much embarrassment. It is important that the businesses ensure that appropriate support/due diligence is conducted before completion of the letters.

CCC/AML Committee. The CCC currently meets monthly and whilst it has improved it appears that there are still many instances where decisions are too slow in being taken and the closure of accounts is delayed significantly by business requests for more time. The presumption seems to be in favour of the businesses views which needs to change to a more Compliance orientated balance. I have asked Ramon who chairs the committee to take a much stricter approach going forward to ensure that suspicious accounts are closed quickly. I have also asked Ramon to consider whether the frequency should be increased to allow more timely consideration of serious cases or authority delegated so that decisions can be taken between meetings. I have also asked that the meeting only deal with high level cases and that the vast majority of cases currently dealt with at the Committee be dealt with outside the Committee and only come to the Committee where business and Compliance cannot agree.

Issues arising from your CNBV visit. I am aware that following your visit to the CNBV with Emilson Alonso and Mike Geoghegan that you have decreed:-

a) That as of the 1st January the Bank will not accept USD cash deposits nor provide exchange services for US dollars. Accordingly no dollars will be accepted by the branches and travellers cheques will not be sold to non-customers and will be sold to customers on a limited basis. There remain AML issues in respect of travellers cheques which historically are very high risk from an AML perspective and accordingly we would expect that the limits are reasonably low and that there are very strong controls in place to ensure that branches do not abuse the rules.

b) That no new Cayman dollar accounts be opened until full remediation of all existing customers.

c) That all remediation for both the Cayman accounts and the restoration project be completed by 31st January. You are aware that remediation has been slow for the Cayman accounts and also for the CMB phase two accounts. We fully support your impetus to speed up the remediation of such accounts. We

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also note that in respect of Cayman it is proposed that 3,000 accounts be closed and our above comments in respect of the account closure backlog and speed need to be addressed. We are also aware that examples are to be set both on a branch and individual basis for failure to follow procedures with respect to account opening, ID and V guidelines. We fully support appropriate action being taken against all individuals who do not comply with the Group's policies.

**Transaction limits** . There are a number of transaction limits. I suggest that the following be reconsidered as appropriate limits and controls be put in place:-

- a) There is no limit on the Bank selling cashiers cheques to customers when they are paid for from the customer's account. This should be subject to appropriate limits and controls.
- b) There is no limit on customers depositing travellers cheques to their accounts.
- c) The Bank will sell up to \$25,000 of travellers cheques when it is paid for from the customer's account. This appears too high and as discussed above we would encourage that a reasonable limit be imposed and strong controls be put in place.
- d) There is some confusion around the limits on wire transfers which should be reviewed.

**CMP/AML Resources** . Having spent time with Jaime Saenz, the new Head of AML, I think that he has good potential. He has our full support and one of his first tasks is to review the resources that he has at his disposal and what activity they conduct. I know that John Rendall has recently approved a new headcount of four which will be very welcome and in addition I have asked Jaime to review all activity currently undertaken by the AML team to ensure that they are not conducting activity that should be conducted by the business and to maximise the use of resources on a timely basis. It appears that in addition to advising the high, medium and low risk parameters that the team has also been asked to actually identify customers that meet these parameters which would appear to me to be a business activity.

**Camp Analysis** . While some work has been done of refining the camp alerts more work is required on refining the "soft rules" to produce focussed meaningful alerts.

Efficiencies can be obtained by a) analysis of the high and medium risk categories on a slightly more sophisticated basis than has been done in the past by analysing the type of activity on the accounts. This may have the effect of actually reducing the number of high and medium risk cases to be remediated. b) more focussed planning initiatives rather than dealing with issues on an ad hoc basis and. c) introduction of review sampling of customer files to ensure high quality KYC/customer visits including supportive documentation. More detailed risk based reviews by Compliance and Internal Control of the business appear necessary.

I am aware that a "AML Shock Plan" is being implemented and this will assist greatly in moving the emphasis/balance of approach to opening/managing customer accounts to group standards.

I look forward to any comments that you have or would welcome further discussion.

Regards.

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HSBC-PSI-PROD-0197876



HBUS Banknotes NY - USD Bought from or Sold to Customers in Mexico: 3-Month Period (Nov-06 to Feb-07)

Customer Name	Type of Client	HSBC Purchase or Sale	100s	50s	20s	10s	5s	2s	1s	Total Amount Traded
BANCO MERCANTIL DEL NORTE (7 branches)	Bank	Purchases	\$18,310,000	\$4,600,000	\$22,380,000	\$3,090,000	\$2,000,000	\$5,400	\$1,186,000	\$51,571,400
BANCO MERCANTIL DEL NORTE (7 branches)	Bank	Sales	\$10,150,000	\$2,000,000	\$200,000	\$0	\$0	\$0	\$0	\$12,350,000
BBVA BANCOMER SA (7 branches)	Bank	Purchases	\$164,025,000	\$23,795,000	\$80,690,000	\$6,862,700	\$3,502,000	\$40,000	\$1,790,200	\$280,704,900
BBVA BANCOMER SA (7 branches)	Bank	Sales	\$2,595,000	\$340,000	\$1,308,000	\$488,000	\$108,000	\$15,200	\$15,300	\$4,869,500
HSBC MEXICO SA (16 branches)	Bank	Purchases	\$341,301,000	\$65,230,150	\$290,120,760	\$23,967,140	\$13,766,570	\$53,800	\$7,956,015	\$742,395,435
HSBC MEXICO SA (16 branches)	Bank	Sales	\$600,000	\$200,000	\$440,000	\$80,000	\$35,000	\$0	\$20,000	\$1,355,000
CASA DE CAMBIO PUEBLA (9 offices)	MSB	Purchases	\$28,520,000	\$13,740,000	\$146,199,000	\$5,347,000	\$1,708,500	\$510,200	\$465,600	\$196,490,300
CASA DE CAMBIO PUEBLA (9 offices)	MSB	Sales	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
CONSULTORIA INTERNACIONAL (4 offices)	MSB	Purchases	\$93,425,000	\$18,119,000	\$73,643,000	\$4,887,000	\$2,508,500	\$17,000	\$1,127,900	\$193,727,400
CONSULTORIA INTERNACIONAL (4 offices)	MSB	Sales	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
All customers in Mexico			\$872,724,600	\$165,595,900	\$788,787,020	\$57,432,870	\$31,461,570	\$686,400	\$17,533,415	\$1,934,221,775

Permanent Subcommittee on Investigations  
EXHIBIT #37a

— = Redacted by the Permanent Subcommittee on Investigations

OCC-PSI-00151506

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EXHIBIT #37b  
HSB00006981  
OCC-PSI-00005890

BANKNOTES-NY Selected Customers' Activity Alerts & Traders' Explanations for USD Purchases & Sales from 2005-2009

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Country	Customer Name	Alert / Review Date	Currency Traded	HBUS Purchase or Sale	USD Equiv Amount (in thousands)	Country Risk Rating	Client Risk (SCC)	Traders' Explanations & Follow-up Info requested/obtained by Compliance
GUATEMALA	[REDACTED] = Redacted by the Permanent Subcommittee on Investigations	Dec-07	USD	P	\$11,360	Cautionary		The financial market in Guatemala was proven weak and inefficient during 2007, and as a result some consolidation and restructuring were part of financial reforms whereby banking sector was reduced. As such, Industrial has gradually increased their USD deposits and December/January are typical months in which family remittances are received.
GUATEMALA		Apr-08	USD	P	\$16,353	Cautionary		The increased banknote volume during May is a direct result of increased tourism in Guatemala where it is still reasonably inexpensive to visit, and also directly generated by their clients in the airlines sector.
GUATEMALA		Dec-08	USD	P	\$19,970	Cautionary		Seasonal increase due to holiday period. [REDACTED] is one of the largest banks in Guatemala, as such and due to the fact that they have a large branch network throughout the country they receive a greater number of cash deposits, especially during high peak tourist and holiday seasons. The bank is also a receptor of USD banknotes which derives from family remittances which typically increase during this period.
GUATEMALA		May-09	USD	S	\$2,099	Cautionary	SCC	New client - Figure is not actual, applies to reversal of purchase on same amount.
GUATEMALA		Aug-09	USD	P	\$7,795	Cautionary	SCC	In Guatemala a mid-year bonus (Bono 14) is given during the month of July. Thanks to this payment the financial sector tend to experience cash surpluses which generate consumer expenditures in electronics, textiles, etc.
MEXICO		Jan-05	USD	P	\$16,107	Standard		[REDACTED] is a new client for us. This time of the year, Mexico has more surplus in cash than any other time of the year to the vast numbers of Mexican visiting relatives/family during the holiday season. A lot of the surplus from the market comes in to the banks in the early part of the new year.
MEXICO		Feb-05	USD	P	\$20,747	Standard		The is a relatively new client and the volume level is in line with the rest of the market participants during this time of the year.
MEXICO		Apr-05	USD	P	\$25,206	Standard		New client, which we have started to operate in July, 2004. Slowly but surely, we are getting a bigger share of the volume against competition.
MEXICO		May-05	USD	P	\$19,299	Standard		With the increase of cities where we make pickups for Bnorte, we are slowly but surely taking away business from competition and increasing our share. This is part of the marketing efforts.
MEXICO		Oct-05	USD	P	\$24,374	Standard		Client is slowly moving a larger percentage of their business from competition to HSBC - due to better terms.
MEXICO		Nov-05	USD	S	\$9,224	Standard		Sales are seasonal for [REDACTED] we've been very aggressive in pricing against our main competitor in Mexico, and have closed additional transactions. The volume is within expectations.
MEXICO		Feb-07	USD	P	\$22,369	Standard		The increase in volume is due to two reasons, 1) early in the year, we tend to see high volume repatriations from Mexico due the end of year/winter return of Mexicans from the USA 2) Excess USD accumulated due to no pick-ups from specific branches for 4 weeks.

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BANKNOTES-NY Selected Customers' Activity Alerts & Traders' Explanations for USD Purchases & Sales from 2005-2009

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MEXICO	<div>Redacted by the Permanent Subcommittee on Investigations</div>	May-07	USD	S	\$6,100	Standard		Due to the approach of the holidays (summer vacations) in Mexico, the demand of USD\$ increases significantly. Also, our logistical process of sending various couriers to México, on a weekly basis has given us the opportunity to offer a more attractive pricing to the customer.
MEXICO		Jul-07	USD	S	\$9,000	Standard		Due holidays (summer vacations) in Mexico, the demand of USD\$ and foreign currency increases significantly. Also, our logistical process of sending various couriers to México, on a weekly basis has given us the opportunity to offer a more attractive pricing to the customer.
MEXICO		Nov-07	USD	S	\$6,500	Standard		The increase in sales is mainly due to the approach of the Christmas season, in which we begin to see a higher demand of US to Mexico. [REDACTED] has always requested quotes for this season from various banks, and their decision was based solely in the cost. Since mid-year we have made logistical changes for the imports to Mexico, this has given us the opportunity to offer [REDACTED] a set rate, and as a result, when they need to import the order is automatically placed directly with HSBC.
MEXICO		Sep-08	USD	P	\$25,894	Standard		During the first months of 2008 the purchases of the USD from Mexico had weakened, due to the instability of the USD. The volatility of MXN currency in the last month, has given the local market the opportunity to sell all USD that they had accumulated for the opportunity of a better rate.
MEXICO		Oct-08	USD	P	\$59,750	Standard		Due to the financial crisis and the volatility of the MXN currency, locals have selling USD that had been accumulated for the opportunity of a better rate.
MEXICO		Aug-09	USD	P	\$8,995	High		During summer season in Mexico, exports tend to decrease as the demand of USD locally is higher due to local holiday season. Additionally overall volume in Mexico is lower than a year ago due to a decrease in tourism caused by the financial crisis and the swine flu situation in this country. [REDACTED] and has limited branches in Mexico City. This deprived them of capturing the HBXM banknotes business when HBXM stopped accepting banknotes from clients.
MEXICO		Aug-05	USD	S	\$5,198	Standard		Not actual sales, entries were created to reverse purchases that needed to be amended.
MEXICO		Jan-07	USD	P+S	\$156M + \$10M	Standard		The branch [REDACTED] is CHIHUAHUA, and the correct volume should be USD2,066,000 (more reasonable). There is one deal on the GBS for USD6,794,000 - that was a mistake and was reversed. Therefore in GBS you have a Purchase and a Sell for the same amount.
MEXICO		Mar-07	USD	S	\$6,524	Standard		The USD SALES were not actual sales, were reversal deals made to modify operations.
MEXICO		Jul-08	USD	S	\$3,042	Standard		This is the high season for cash demand, therefore the orders are larger. Also, in May, 2008 several branches [REDACTED] which were only acting as servicing branches (only received USD), have become full branches providing the complete service of selling and purchase from customers.
MEXICO		Oct-08	USD	P	\$318,319	Standard		Due to the financial crisis and the volatility of the MXN currency, locals have selling USD that had been accumulated for the opportunity of a better rate.

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## BANKNOTES-NY Selected Customers' Activity Alerts &amp; Traders' Explanations for USD Purchases &amp; Sales from 2005-2009

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Country	Customer Name	Alert / Review Date	Currency Traded	HBUS Purchase or Sale	USD Equiv Amount (in thousands)	Country Risk Rating	Client Risk (SCC)	Traders' Explanations & Follow-up Info requested/obtained by Compliance
MEXICO	[REDACTED]	Apr-09	USD	S	\$1,077	High		Figure is not actual - a reversal of a purchase of \$1,076,000.
MEXICO		May-09	USD	S	\$1,220	High		Figure is not actual, applies to a reversal of a purchase on the amount of \$1,215,200.00, and various CTF's off-sets deals.
MEXICO		Jul-09	USD	S	\$1,326	High		Not a live deal, transaction was created to reverse trade B0907003350, client reported incorrect amount.
MEXICO		Aug-09	USD	P	\$122,929	High		During summer season in Mexico, exports tend to decrease as the demand of USD locally is higher due to local holiday season. Additionally overall volume in Mexico is lower than a year ago due to a decrease in tourism caused by the financial crisis and the entire flu situation in this country.
								[REDACTED] has a strong presence in the local market and since HBMMX stopped accepting foreign currency from their clients, they were able to capture part of this volume - compensating the overall decrease in total surplus from Mexico due to drop in tourism and family remittances.
MEXICO		Mar-05	USD	S	\$5,519	Standard		Reversal Deals.
MEXICO		Oct-06	USD	S	\$7,814	Standard		This is a reversal deal to correct a buy deal input error.
MEXICO		Sep-07	USD	S	\$7,078	Standard		The Sales volume is not actual activity, but, rather reversal of deals on the system due to change in shipment dates and or denominations.
MEXICO	CASA DE CAMBIO PUEBLA SA DE CV	Feb-06	USD	P	\$18,337	Standard	SCC	The is a relatively new client and the volume level is in line with the rest of the market participants during this time of the year. Furthermore, our pricing and value date structure has improved the clients ability to compete aggressively.
MEXICO	CASA DE CAMBIO PUEBLA SA DE CV	May-05	USD	P	\$24,595	Standard	SCC	We commenced business with this name on November 2004, the monthly average is not the true 12 month average. Our better pricing and more collection points is landing us more business versus competition.
MEXICO	CASA DE CAMBIO PUEBLA SA DE CV	Oct-06	USD	P	\$27,746	Standard	SCC	The volume is consistent with our expectations. We have also commenced business with their Cancun branch that is translating to more business.
MEXICO	CASA DE CAMBIO PUEBLA SA DE CV	Nov-05	USD	P	\$35,092	Standard	SCC	Increase due to additional collection from 3 different locations/branches.
MEXICO	CASA DE CAMBIO PUEBLA SA DE CV	Feb-06	USD	P	\$38,742	Standard	SCC	This volume is due to two reasons, 1) early in the year, we tend to see high volume repatriations from Mexico due the end of year/winter return of Mexicans from the USA 2) Client is slowing growing its business volume as a result of better cash flow thanks to dealing with HSBC i.e. faster turn around of banknotes.
MEXICO	CASA DE CAMBIO PUEBLA SA DE CV	Mar-06	USD	P	\$53,905	Standard	SCC	Client is slowing growing its business volume as a result of better cash flow thanks to dealing with HSBC i.e. faster turn around of banknotes. Client has also captured more business due to other participants discontinuation of business.
MEXICO	CASA DE CAMBIO PUEBLA SA DE CV	Apr-06	USD	P	\$54,206	Standard	SCC	With HSBC, client gets credit same day as pickup in Mexico which has improved their cash flow. In turn, they are passing part of the savings to their client by giving their clients same day value too. As a result, CCP is attracting more business from the corporate clients.

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[REDACTED] = Redacted by the Permanent Subcommittee on Investigations

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BANKNOTES-NY Selected Customers' Activity Alerts & Traders' Explanations for USD Purchases & Sales from 2005-2009

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MEXICO	CASA DE CAMBIO PUEBLA SA DE CV	Sep-06	USD	P	\$76,569	Standard	SCC	Mexico as a whole and more specifically CCP is the premier country/mab USD remitter. There is an large population of Mexican's working in the U.S. during the summer months (landscaping) that send money back home (religiously) to their families.
MEXICO	CASA DE CAMBIO PUEBLA SA DE CV	Mar-07	USD	P	\$113,267	Standard	SCC	Part of the volume increase for this name is the end result of BoIA not servicing MSB's - which has increased the wallet size for other local players. In addition, Torre Mayor branch which opened for business operations in late January had captured more business due to strategic location.
MEXICO	Redacted by the Permanent Subcommittee on Investigations	Mar-06	USD	P	\$19,300	Standard	SCC	Client is shifting volume previously given to competition.
MEXICO		Sep-06	USD	P	\$26,700	Standard	SCC	This is a new client that has BN relationship with competition. Our aggressive pricing and excellent service is landing us more volume.
MEXICO		Dec-06	USD	P	\$45,859	Standard	SCC	Bank of America has terminated their relationship with all MSB's. As such, we are gaining more share of the wallet with Wachovia in various cities in Mexico.
MEXICO		Feb-07	USD	P	\$69,797	Standard	SCC	They have begun to operate 2 additional branches. In addition, volumes are within the expectations due to the season.
MEXICO		Jun-07	USD	P	\$74,429	Standard	SCC	In comparison of June 06, we have begun to operate 3 additional branches, GDL (Mid June 06, Leon, Late December 06 and Cancun, Mid December 06). Also, Client is slowly shifting their complete business to HSBC, which was originally shared with BOFA.
MEXICO		Aug-07	USD	S	\$1,800	Standard	SCC	As a result of our new structure in which we are sending the values via airfreight, allows us to delivery any day of the week, versus the original scheduled which was once a week (via courier), we have been able to capture the majority of their business.
MEXICO		Oct-07	USD	S	\$6,000	Standard	SCC	The USD sales increase is a combination of two factors; (1) American Express has stopped selling T/C's to CC's in Mexico, they only sell them to banks, and CC's can not purchase T/C's from banks. Normally CC's would split their local sale, in cash and in T/C's, due to this situation, their clients are entirely purchasing cash. As a result their demand for USD has increased. (2) Our new logistical structure in which we are sending the values via airfreight, allows us to delivery any day of the week.
MEXICO		Mar-08	USD	S	\$2,000	Standard	SCC	Due to the holidays (Holy Week in Mexico during March) demand for USD increases significantly. Also, client has the advantage to order on a daily basis, versus scheduled days (Tuesdays and Wednesday), which has given them more room to negotiate sell to their local clients.
MEXICO		Apr-08	USD	S	\$6,000	Standard	SCC	Due to the holidays "Spring Break", the demand for USD and EURO increases significantly, locals tend to do international tourism. Also, we have improved our operational structure and have been able to provide the customer a more attractive schedule and pricing.
MEXICO		Jul-08	USD	S	\$7,000	Standard	SCC	Due to the high season (summer vacations) the cash demand increases significantly in Mexico.

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BANKNOTES-NY Selected Customers' Activity Alerts & Traders' Explanations for USD Purchases & Sales from 2005-2009

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MEXICO	<div>Redacted by the Permanent Subcommittee on Investigations</div>	Oct-08	USD	P	\$55,261	Standard	SCC	Due to the financial crisis and the volatility of the MXN currency, locals have selling USD that had been accumulated for the opportunity of a better rate.
MEXICO		Dec-08	USD	S	\$3,500	Standard	SCC	Seasonal increase due to holiday period. Mexico has historically ordered USD and EUR during holiday periods for travelling purposes.
MEXICO		Feb-09	USD	P	\$57,033	Standard	SCC	The increase in purchases is due to two reasons: 1) Beginning January 1, 2009, HBMX stopped receiving USD cash and we have begun to receive higher volumes of USD cash from our local clients in Mexico. 2) Effective March 31, HSBC will exit the Banknotes relationship with CIB, and as a direct result they have been collecting their entire surplus from other locations to relieve their inventory for this date.
MEXICO		Mar-09	USD	P	\$7,218	Standard	SCC	Client is shifting volume previously given to competition.
MEXICO		Apr-09	USD	P	\$6,342	Standard	SCC	Client is slowly growing its business volume as a result of better cash flow thanks to dealing with HSBC i.e. faster turn around of banknotes. Client has also captured more business due to other participants discontinuation of business.
MEXICO		Mar-07	USD	P	\$10,223	Standard	SCC	Part of the volume increase for this name is the end result of BoA not servicing MSB's which has increased the wallet size. Additional volume was received from [REDACTED] [REDACTED] which began to sale their USD excess to HBUS during 1Q7.
MEXICO		May-07	USD	S	\$4,000	Standard	SCC	Due to the approach of the holidays (summer vacations) in Mexico, the demand of USD's and foreign currency increases significantly. Also, our logistical process of sending various couriers to Mexico, on a weekly basis has given us the opportunity to offer a more attractive pricing to the customer.
MEXICO		Oct-07	USD	S	\$8,200	Standard	SCC	The USD sales increase is a combination of two factors: (1) American Express has stopped selling T/C's to CC's in Mexico, they only sell them to banks, and CC's can not purchase T/C's from banks. Normally CC's would split their local sells, in cash and in T/C's, due to the situation; their clients are entirely purchasing cash. As a result their demand for USD has increased. (2) Our new logistical structure in which we are sending the values via airfreight, allows us to delivery any day of the week.
MEXICO		Apr-08	USD	S	\$7,000	Standard	SCC	Due to the holidays "Spring Break", the demand for USD and EURO increases significantly, locals tend to do international tourism. Also, we have improved our operational structure and have been able to provide the customer a more attractive schedule and pricing.
MEXICO		Sep-08	USD	P	\$3,778	Standard	SCC	Customer's volumes have gradually decreased during mid 2007, mainly due to a complete restructure of their client portfolio. Total volumes in Mexico are increasing due to the international financial crisis and consequent devaluation of the Mexican Peso. The volume for Interam is 26% lower than same month last year and the increase when comparing with the 12-Mo averaged is explained by the general increase of the volumes in Mexico, particularly if we have in consideration that USD's were purchased on September 30th.

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BANKNOTES-NY Selected Customers' Activity Alerts & Traders' Explanations for USD Purchases & Sales from 2005-2009

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MEXICO	<div>Redacted by the Permanent Subcommittee on Investigations</div>	Oct-08	USD	P	\$12,614	Standard	SCC	Due to the financial crisis and the volatility of the MXN currency, locals have selling USD that had been accumulated for the opportunity of a better rate.
MEXICO		Dec-08	USD	P+S	\$10M + \$5M	Standard	SCC	Purchases: Client sold excess cash of almost \$5Mio on 12/31 to clear inventory at the end of the year. Sales: Seasonal increase due to holiday period.
MEXICO		Feb-09	USD	P	\$8,982	Standard	SCC	The increase in purchases is due to two reasons: 1) Beginning January 1, 2009, HBMX stopped receiving USD cash and we have begun to receive higher volumes of USD cash from our local clients in Mexico. 2) Effective March 13, HSBC will exit the Banknotes relationship with Interam, and as a direct result they have been collecting their entire surplus from other locations to relieve their inventory for this date.
MEXICO		Mar-05	USD	P	\$3,630	Standard		New client, which we have started to operate in January, 2005.
MEXICO		Aug-05	USD	P	\$10,694	Standard		New client, volume is within expectations.
MEXICO		Jan-08	USD	P	\$5,112	Standard		In 2007, client went under a restructure when adding an additional branches to their network, nationwide. At that time, they were supplying all the new branches with the surplus of the Main Branch. This process has finished and completed, we have begun to receive their entire banknotes surplus.
MEXICO		May-08	USD	S	\$2,000	Standard		This particular client always request quotes from various Banks, and will close transaction considering the following: day of delivery and lowest bidder. Transaction was closed considering that we were able to consolidate shipment with other banks and offered an attractive quote which was accepted.
MEXICO		Nov-08	USD	P	\$6,428	Standard		Due to the financial crisis and the volatility of the MXN currency, locals sold USD that had been accumulated for the opportunity of a better rate.
MEXICO		Jan-09	USD	P	\$11,220	Standard		As of January 1, 2009 HSBC Mexico management announced that the bank would no longer receive USD cash deposits in any format. As such, other banknote clients in Mexico, including client, began to collect part of the cash surplus in the local market. We will conduct a new volume review in order to update the KYC with more realistic values.
MEXICO		Aug-09	USD	P	\$3,600	High	SCC	During summer season in Mexico, exports tend to decrease as the demand of USD locally is higher due to local holiday season. Additionally overall volume in Mexico is lower than a year ago due to a decrease in tourism caused by the financial crisis and the swine flu situation in this country. client is currently opening new branches and aggressively pursuing more business that has led it to grow its volume in comparison to the past. We are also told that they are giving HSBC more of its business than BofA.
MEXICO		Sep-09	USD	P	\$8,326	High	SCC	client is currently opening new branches and aggressively pursuing more business that has led it to grow its volume in comparison to the past. We are also told that they are giving HSBC more of its business than BofA.
PANAMA		Apr-05	USD	P	\$2,600	Cautionary		This is a new client since June 2004. The volume is within our expectations.
PANAMA		Jun-05	USD	P	\$3,500	Cautionary		We started to do business with them in mid-June, 2004. The volumes are with our expectation.

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PANAMA	<div>Redacted by the Permanent Subcommittee on Investigations</div>	Jan-06	USD	P	\$1,400	Cautionary		██████████ had been sharing the banknotes business between BNP, and HSBC. We have obtained 100% of the business.
PANAMA		Mar-06	USD	P	\$1,800	Cautionary		Volume within expected levels
PANAMA		May-06	USD	P	\$2,650	Cautionary		On the average the bank exports two times per month, however during May 2006 they had residual cash from the previous month.
PANAMA		Nov-06	USD	P	\$2,050	Cautionary		Accumulated volumes from October, which where not repatriated due to local holidays in Panama.
PANAMA		Feb-07	USD	P	\$4,750	Cautionary		On the average the bank exports two times per month, however during February 2007 they had residual cash from the previous month.
PANAMA		Aug-07	USD	P	\$5,660	Cautionary		██████████ was sharing business with BNP 30%, and the remaining with HSBC. They have begun to repatriate the 100% of their business with HSBC. Volumes within expectations.
PANAMA		Jan-08	USD	P	\$7,050	Cautionary		██████████ was sharing business with BNP 30%, and the remaining 70 % with HSBC by mid July 2007 they have begun to repatriate 100% of their business with HSBC. In addition to this, is the Christmas Season, which we normally see the repatriation by following month (January).
PANAMA		Apr-08	USD	P	\$8,015	Cautionary		The excess of purchases on the amount of \$665K for this client is mainly based upon our itinerary changes on shipments from Panama. We had exported the last day of the prior month, but ██████████ (who normally exports on a weekly basis), was not ready for export the last week of March, reporting the 1st of April.
PANAMA		Sep-08	USD	P	\$2,140	Cautionary		Previously ██████████ was not only a Banknotes client, but also was used as a local provider for HBUS in Panama. HBUS was vaulting other client's values in ██████████ facilities - until the day of the exports. This gave us the opportunity to collect practically on a daily basis for ██████████. This facilitated them with issue of the local insurance, once the shipment was collected from their facilities in was within the HBUS insurance and vaulted of the ██████████ vault. After the decision of ██████████ to sell all their USD excess to BNP, they also exited the service of vaulting for HBUS. This has affected tremendously our banknotes business with ██████████ which in the past would report from 2 to 3 times a week, and now can only report the day prior to the shipments, which is done once a week. As a result we've began to see a decrease of volume from ██████████.
PANAMA		Apr-05	USD	P	\$3,640	Cautionary		We have resumed to trade with the ██████████ Branch since the beginning of 2005, hence the increased volume. BN Profile will be updated during review.
PANAMA		May-05	USD	P	\$3,255	Cautionary		The increase is due us making collection at the ██████████ Trade Zone branch i.e. we have added another location/branch to make pickups.
PANAMA		Aug-05	USD	P	\$3,450	Cautionary		Increase due to additional collection from a different location/branch.
PANAMA		Oct-05	USD	P	\$4,300	Cautionary		Panama is a dollarized economy. The higher volume of repatriation is a conscious effort by the bank to keep an optimum inventory and avoid additional costs of funds.



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BANKNOTES-NY Selected Customers' Activity Alerts & Traders' Explanations for USD Purchases & Sales from 2005-2009

LCO reviews current & prior explanations from trader & client along with info in KYC profiles and recent activity for customer and country (in GBS) to confirm.  
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Country	Customer Name	Alert / Review Date	Currency Traded	HBUS Purchase or Sale	USD Equiv Amount (in thousands)	Country Risk Rating	Client Risk (SCC)	Traders' Explanations & Follow-up Info requested/obtained by Compliance
PANAMA	[REDACTED] = Redacted by the Permanent Subcommittee on Investigations	Feb-08	USD	P	\$3,600	Cautionary		The excess in purchases is due to two reasons: (1) Seasonal (carnival), we tend to see an increase of volumes during this season due to tourism; (2) [REDACTED] has added more corporate clients to their portfolio and as result we have begun to see the increase in the exports. [REDACTED] expanded their business with corporate clients in the [REDACTED] Free Trade Zone. These corporate clients are oriented to the retail business of any kind of products (perfumes, toys, electronics, etc). Moreover, the European tourism is having a strong purchase power, increasing significantly the commercial activity in the FTZ
PANAMA		Mar-05	USD	S	\$1,990	Cautionary		Reversal Deals
PANAMA		Aug-05	USD	P	\$18,550	Cautionary		Because of a strong marketing strategy, [REDACTED] has been able to expand the local client base, increasing the repatriation of Bank-Notes.
PANAMA		Sep-05	USD	P	\$24,755	Cautionary		Within our expectation, client had informed us of their local marketing strategy. They are targeting more client locally with aggressive terms i.e. making collections from major retail outlets at no fees. This is tending them more volume.
PANAMA		Dec-05	USD	P+S	\$28M + \$7M	Cautionary		The increase is due to an additional collection at the [REDACTED] Free Trade Zone branch i.e. we have added another location/branch to make pickups.
PANAMA		Mar-06	USD	S	\$2,050	Cautionary		Reverse deal to modify pricing
PANAMA		May-06	USD	S	\$2,085	Cautionary		Reversal deal no B0605002563 to correct deal input.
PANAMA		Oct-06	USD	S	\$18,830	Cautionary		This is a reversal deal to correct a buy deal input error.
PANAMA		Nov-08	USD	S	\$3,640	Cautionary		Reversal deal
PANAMA		Oct-09	USD	P	\$3,925	Cautionary		Previously, [REDACTED] was not only a Banknotes client - but also was used as a local provider for HBUS in Panama. HBUS was vaulting other client's cash & valuables in [REDACTED] facilities - until the day of the exports. This gave us the opportunity to collect practically on a daily basis for Multibank, Inc. This facilitated them with local insurance, once the shipment was collected from their facilities it was within the HBUS insurance and vaulted of the [REDACTED] vault. After the decision of [REDACTED] to sell all their USD excess to BNP, they also exited the service of vaulting for HBUS. This has affected tremendously our banknotes business with [REDACTED] - the past they would report from 2 to 3 times a week but now can only report the day prior to the shipments - which is done once a week. As a result we've begun to see a decrease of volume from [REDACTED]
PANAMA		Apr-05	USD	P	\$1,835	Cautionary		This is a new client since May 2004. The volume of April is in line with our expectation and the 12 month average on this table is not a correct reflection of its monthly average.
PANAMA		Sep-05	USD	P	\$3,035	Cautionary		[REDACTED] had been deviating slowly in the past months their repatriation from BNP to HBUS. We have obtained 100% of the business.
PANAMA		Dec-05	USD	P	\$2,755	Cautionary		We have obtained 100% of their business since October 2005, volumes within our expectations.
PANAMA		Oct-08	USD	P	\$3,129	Cautionary		On the average, bank is exporting weekly, however during early October, they had residual cash from the previous month.
PANAMA		Feb-08	USD	P	\$4,350	Cautionary		The increase that we are actually seeing is mainly to the Carnival Season (tourism), in which we tend to see an increase in the volumes.

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BANKNOTES-NY Selected Customers' Activity Alerts & Traders' Explanations for USD Purchases & Sales from 2005-2009

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Country	Customer Name	Alert / Review Date	Currency Traded	HBUS Purchase or Sale	USD Equiv Amount (in thousands)	Country Risk Rating	Client Risk (SCC)	Traders' Explanations & Follow-up info requested/obtained by Compliance
PANAMA	[REDACTED] = Redacted by the Permanent Subcommittee on Investigations	Apr-08	USD	P	\$5,030	Cautionary		The volume is not correct; we had to modify a deal in order to cancel an operation. The actual volume of the Purchases: USD3.8MM.
PANAMA		May-08	USD	P	\$4,640	Cautionary		This year the business activity from the [REDACTED] Free Zone has been slowly increasing, as a result the surplus of USD will increase as well.
PANAMA		Oct-08	USD	P	\$6,715	Cautionary		The excess in purchases is due mainly to the addition of added more corporate clients (wholesalers based in [REDACTED] Free Trade Zone) to their portfolio and as result we have begun to see the increase in the exports.
PANAMA		Oct-09	USD	P	\$6,640	Cautionary		Although the Panamanian market has become a challenge for the Banknotes business, [REDACTED] has been one of the few Banks in Panama that have continued to export the 100% of the excess USD cash to HBUS. The increase during this month is mainly based on the fact that HBUS will not export until we reach a minimum amount to cover our fixed cost, and [REDACTED] sold the cash one week from prior month, in order to ship thru us. Average has been consistent during 2009.
PARAGUAY		Nov-05	USD	P	\$54,500	Cautionary		Increase is due to the modifications of the tax regulations of Paraguay. For the sector of personal computers and related components the tax is exonerated from 1/1/2005 to 12/31/2005. We have learned that clients have decided to sell all the USD excess to the local banks instead of the house exchanges.
PARAGUAY		May-06	USD	P	\$76,590	Cautionary		The increased volume was driven by the increase of activity of corporate clients engaged in sales of electronics, computer software and hardware. [REDACTED] has taken an aggressive approach to obtain the banknotes business from the corporate sector. [REDACTED] had reported to conduct banknotes business with 72 Paraguayan Corporations generating the USDollars and foreign currency banknotes surplus.
PARAGUAY		Dec-07	USD	P	\$77,000	Cautionary		Starting in December we increased our flight's frequency, from one to three flights per week. This allowed our clients to improve their cash flow and be more aggressive, increasing the total volume of the business.
PARAGUAY		Jan-05	USD	P	\$8,800	Cautionary		The volume is within the expected range during this time of the year. Historically, we have seen more cash in the market from banks due to holiday season shopping. This comes back to the bank for liquidation.
PARAGUAY		Jan-07	USD	P	\$3,280	Cautionary		In line with Monthly Trade Volume Estimates. They shipped in January part of the cash they collected during December. That's why when you compare Dec-06 Vs Dec-05 you see a reduction in the USD activity but an increase when you compare Jan-07 Vs Jan-06. But overall activity is about the same.
PARAGUAY		Jul-07	USD	P	\$2,852	Cautionary		[REDACTED] has some volatility in the monthly volumes but these figures are in line with monthly trade volumes estimates. Currently the main reason for the surplus of USD in Paraguay is due to tourists coming from Foz de Iguazu, Brazil and Puerto Iguazu, Argentina; going to Ciudad del Este for shopping.
PARAGUAY		Dec-07	USD	P	\$4,600	Cautionary		Starting in December we increased our flight's frequency, from one to three flights per week. This allowed our clients to improve their cash flow and be more aggressive, increasing the total volume of the business.

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BANKNOTES-NY Selected Customers' Activity Alerts & Traders' Explanations for USD Purchases & Sales from 2005-2009

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Country	Customer Name	Alert/ Review Date	Currency Traded	HBUS Purchase or Sale	USD Equiv Amount (in thousands)	Country Risk Rating	Client Risk (SCC)	Traders' Explanations & Follow-up info requested/obtained by Compliance
PARAGUAY	[REDACTED] = Redacted by the Permanent Subcommittee on Investigations	Nov-08	USD	P	\$4,900	Cautionary		USD volumes in Paraguay are seasonal and that's why the monthly volume was higher than average. Additionally, as a way to improve their liquidity, this bank reduced the charges for accepting USD from the retail sector and therefore they were able to increase the total amount of deposits in their USD accounts.
PARAGUAY		Dec-08	USD	P	\$11,500	Cautionary		During the last few months, [REDACTED] was keeping a larger inventory of USD notes than usual as a way to improve their liquidity. They are currently exporting their surplus.
PARAGUAY		Jan-09	USD	P	\$21,200	Cautionary		During the last few months, [REDACTED] was promoting new USD deposits by lowering the charges to their clients for deposits in foreign currency, they implement this strategy as a way to improve their liquidity position.
PARAGUAY		Oct-09	USD	P	\$1,050	Cautionary		In Paraguay we are observing a shift in the banknotes business where [REDACTED] is taking the place of the USD and at a market level. Total USD volume is significant lower.
PARAGUAY		Jan-05	USD	P	\$6,150	Cautionary		The volume is within the expected range during this time of the year. Historically, we have seen more cash in the market from banks due to holiday season shopping. This comes back to the bank for liquidation.
PARAGUAY		Oct-06	USD	P	\$2,295	Cautionary		The banknotes volume decreased is due to the loss of market share of the corporate sector. Corporate clients decided to transfer bank activity to other Paraguayan banks due to the uncertainty of the closing of [REDACTED]
PARAGUAY		Feb-07	USD	P+S	\$3M + \$2M	Cautionary		The USD SALES were not an actual sell, it was a reversal deal made to modify an operation. The actual volume was USD purchases for USD1,000,000.-
PARAGUAY		Feb-05	USD	P	\$13,668	Cautionary		The slightly higher surplus is from the market due to increased commerce from travelers and buyers from the region coming to Ciudad de Este to purchase electronic goods. The carnival season in Brazil is a time when Brazilian take short trips to Ciudad de Este for shopping.
PARAGUAY		Mar-05	USD	P	\$13,995	Cautionary		The volume is in line with our expectation. [REDACTED] signed new Corporate Client (Computers and electronics) in recent months. The hiring of [REDACTED] and [REDACTED] is paying dividends to increase the volumes of deposits and support to import and export businesses in Asuncion and Ciudad del Este. [REDACTED] has a significant segment of clients from the Jewish community in Paraguay. (Monthly Volume estimate of purchases USD14,000,000.00)
PARAGUAY		Aug-05	USD	P	\$20,875	Cautionary		[REDACTED] has gained market share due to aggressive marketing and lower pricing to local clients.
PARAGUAY		Nov-07	USD	P	\$11,885	Cautionary		Due to its geographical location, this bank has many clients in the agribusiness sector and therefore their volumes are seasonal.
PARAGUAY		Dec-07	USD	P	\$16,981	Cautionary		Starting in December we increased our flight's frequency, from one to three flights per week. This allowed our clients to improve their cash flow and be more aggressive, increasing the total volume of the business.

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OCC-PSI-00005590

## BANKNOTES-NY Selected Customers' Activity Alerts &amp; Traders' Explanations for USD Purchases &amp; Sales from 2005-2009

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Country	Customer Name	Alert/ Review Date	Currency Traded	HBUS Purchase or Sale	USD Equiv Amount (in thousands)	Country Risk Rating	Client Risk (SCC)	Traders' Explanations & Follow-up Info requested/obtained by Compliance
PARAGUAY	[REDACTED] Redacted by the Permanent Subcommittee on Investigations	May-08	USD	P	\$16,935	Cautionary		Since last November, [REDACTED] was able to capture some of their competitor's clients, increasing the volume of their banknotes operation; additionally during last year they opened some new branches allowing them to further expand their business.
PARAGUAY		Jul-09	USD	P	\$13,881	Cautionary	Watchlist	Since we exited our relationship with [REDACTED], the rest of the banks in Paraguay are competing to capture their market share, increasing monthly volumes.
PARAGUAY		Mar-05	USD	P	\$3,000	Cautionary		The volume is in line with our expectation. [REDACTED] started trading with HSBC on June 2004. We did not have statistics for March 2004. (Monthly Volume estimate of purchases USD3,000,000.00)
PARAGUAY		Apr-05	USD	P	\$5,500	Cautionary		We commenced business with this client mid last year and the average is not the true reflection of its monthly volume. The activity is in line with our expectation for this state owned bank.
PARAGUAY		May-05	USD	P	\$6,000	Cautionary		This is relatively new client and the volume is in line with the expectation.
PARAGUAY		Jun-05	USD	P	\$8,500	Cautionary		BNF first trade was executed on June 23rd, 2004. BNF exported in the month of June 2005 100% of the activity generated with HSBC.
PARAGUAY		Feb-07	USD	P	\$2,500	Cautionary		During the last year this client was with an unusual low level of volume due to some concern about the security of their international banknotes business as a consequence of an adverse result in a legal litigation against the Paraguayan Government. They are trying to restart the business and hopefully we will see an increase in the activity for this account.
PARAGUAY		Apr-07	USD	P	\$4,000	Cautionary		During more than a year they were almost inactive in the international banknotes business due to litigation against the Paraguayan Government in Switzerland. [REDACTED] Currently they are restarting their international operations. There is no impact on us other than the reduction of the volumes with [REDACTED]. They were liquidating the surplus of USD in the local market and finally was exported for some other banks in Paraguay. I'm sending an E-mail with the call report separately.
PARAGUAY		May-05	USD	P	\$2,000	Cautionary		This is a new client and the volume is in line with our expectations.
PARAGUAY		Jun-05	USD	P	\$8,950	Cautionary		New relationship with [REDACTED] and the first trade was executed on May 18th, 2005. Slowly but surely, they are giving us most of their business that was previously liquidated locally.
PARAGUAY		Oct-05	USD	P	\$7,900	Cautionary		[REDACTED] Paraguay is a new client that commenced business with HSBC on 05.23.05. The volume is consistent with our expectations.
PARAGUAY		Feb-06	USD	P	\$6,000	Cautionary		[REDACTED] commenced banknotes exports of USDollars on May 23, 2005. The volume is in line with our expectations.
PARAGUAY		Mar-06	USD	P	\$9,000	Cautionary		[REDACTED] commenced banknotes exports of US Dollars on May 23, 2005. The volume is in line with our expectations USD2mm per week.
PARAGUAY		Nov-07	USD	P	\$6,090	Cautionary		Due to its geographical location, this bank has many clients in the agribusiness sector and therefore their volumes are seasonal.

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**BANKNOTES-NY Selected Customers' Activity Alerts & Traders' Explanations for USD Purchases & Sales from 2005-2009**

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Country	Customer Name	Alert / Review Date	Currency Traded	HBUS Purchase or Sale	USD Equiv Amount (in thousands)	Country Risk Rating	Client Risk (SCC)	Traders' Explanations & Follow-up Info requested/obtained by Compliance
PARAGUAY	<div>Redacted by the Permanent Subcommittee on Investigations</div>	Jul-08	USD	P	\$8,788	Cautionary		The volume of the Banknotes business in the Paraguayan market increased mainly due to the strong Brazilian currency exchange rate that promoted the commercial activity in Ciudad del Este. This effect was not fully reflected before with this client, because due to the soya harvest season a large amount of USD banknotes were needed locally.
PARAGUAY		Nov-08	USD	P	\$8,273	Cautionary		USD volumes in Paraguay are seasonal and that's why the monthly volume was higher than average. Additionally, [REDACTED] growing their business strongly, they are expanding their net of branches and also they are in the process of acquiring [REDACTED]
PARAGUAY		May-09	USD	P	\$7,032	Cautionary		The USD activity for this bank has a seasonal component related to agricultural business. Additionally due to lower prices for agribusiness products, like soya, there was a reduction on the amount of US notes needed to cover the local demand and consequently there was an increase in the surplus of notes exported. Volume is within expected values.
PARAGUAY		Jul-09	USD	P	\$12,422	Cautionary		Since we exited our relationship with [REDACTED] the rest of the banks in Paraguay are competing to capture their market share, increasing monthly volumes.
PARAGUAY		Sep-09	USD	P	\$3,351	Cautionary		[REDACTED] based in the city of [REDACTED] and had been focused in providing their services to the agricultural sector and therefore their banknotes volume had a strong seasonal component, which implies a high volatility in monthly volumes when comparing with 12-Mo Average. They are currently in the process of acquiring [REDACTED] which will allow them to expand their business and provide their services to a broader customer base. Additionally in Paraguay we are observing a shift in the banknotes business where BRL is taking the place of the USD and at a market level total USD volume is significant lower.
PARAGUAY		Mar-05	USD	P	\$12,000	Cautionary		[REDACTED] increased the Corporate Client Base. Mandate from Brazil for 2005 is to grow. Recently, counterparty bought the credit card business from Citibank. The desk also re-hired [REDACTED] is well regarded in the market. [Monthly Trade Volume estimate purchases USD12,000,000.00]
PARAGUAY		Jan-07	USD	P	\$4,500	Cautionary		In line with Monthly Trade Volume Estimates. They shipped in January part of the cash they collected during December. That's why when you compare Dec-06 vs Dec-05 you see a reduction in the USD activity but an increase when you compare Jan-07 vs Jan-06. But overall activity is about the same.
PARAGUAY		Aug-07	USD	P	\$6,000	Cautionary		Most of the USD notes are collected by [REDACTED] in their retail branches. They have significant fluctuation in the volumes, as mentioned in the KYC profile, due to variations in the level of commerce. Total volume is within expectations.
PARAGUAY		Dec-07	USD	P+S	\$15,000	Cautionary		Starting in December we increased our flight's frequency, from one to three flights per week. This allowed our clients to improve their cash flow and be more aggressive, increasing the total volume of the business.
PARAGUAY								

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BANKNOTES-NY Selected Customers' Activity Alerts & Traders' Explanations for USD Purchases & Sales from 2005-2009

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Country	Customer Name	Alert / Review Date	Currency Traded	HBUS Purchase or Sale	USD Equiv Amount (in thousands)	Country Risk Rating	Client Risk (SC)	Traders' Explanations & Follow-up Info requested/obtained by Compliance
PARAGUAY	<div>Redacted by the Permanent Subcommittee on Investigations</div>	Jul-08	USD	P	\$9,000	Cautionary		The volume of the Banknotes business in the Paraguayan market increased mainly due to the strong Brazilian currency exchange rate that promoted the commercial activity in [REDACTED]. This effect was not fully reflected before with this client, because due to the soya harvest season a large amount of USD banknotes were needed locally.
PARAGUAY		Jan-09	USD	P	\$8,500	Cautionary		The USD activity for this bank has a seasonal component related to tourism and commerce in the tri-border area. Volume is consistent with Jan-08 volume and within expectations.
PARAGUAY		Mar-09	USD	P	\$7,500	Cautionary		The USD activity for this bank has a seasonal component related to tourism and commerce in the tri-border area. Additionally due to lower prices for agribusiness products, like soya, there was a reduction on the amount of US notes needed to cover the local demand and consequently there was an increase in the surplus of notes exported.
PARAGUAY		Aug-08	USD	S	\$2,000	Cautionary		Not a live deal, transaction was created to reverse trade B09080000654.
PARAGUAY		Aug-08	USD	P	\$19,500	Cautionary		[REDACTED] has been losing market share due to putting restriction on the pay of USD - they had a lot of small denoms that they wanted to get rid of so client were forced to take them. They are slowing moving away from this special condition and willing to pay out in brand new bills.
PARAGUAY		Nov-08	USD	P	\$12,379	Cautionary		USD volumes in Paraguay are seasonal and that's why the monthly volume was higher than average. In this case the monthly volume is almost the same than last year monthly volume.
PARAGUAY		Feb-09	USD	P	\$10,673	Cautionary		[REDACTED] was able to get back part of the volume their lost last year, increasing their USD exports. 12-Mo Average for previous year was about \$12MM. In Paraguay, there is an in-flow of US banknotes originated in the commercial activity in the tri-border area, and an out-flow of US banknotes caused by payments from agribusinesses to their workers and suppliers, last year the soy prices were extremely high and therefore a large amount of US notes were used by this sector, reducing the total surplus to be exported, the year the soy price is 40% lower, reducing the amount of US notes needed to cover the local demand and consequently there is an increase in the surplus of notes exported.
PARAGUAY		Jul-08	USD	P	\$13,034	Cautionary		Since we exited our relationship with [REDACTED] the rest of the banks in Paraguay are competing to capture their market share, increasing monthly volumes.
URUGUAY		Mar-05	USD	P+S	\$5.8M + \$55M	Medium		At the beginning of March a financial institution was suspended by the Central Bank originating some uncertainty on the market, and several Banks bought USD to be able to respond in the case that the public start to withdraw deposits from the system, situation that finally didn't happen.
URUGUAY		May-05	USD	P	\$8,063	Medium		They are collecting all the old notes from the banking system (before series 1996).
URUGUAY		Jul-05	USD	P+S	\$43M + \$60M	Medium		The correct purchase volume is \$3.112 mio and the sales is \$20 m. This difference is due to reversal deals passed after logistical hardships were encountered to delay shipments. The steady demand from Uruguay due to the unwinding of the deposits that were frozen during the financial crisis in 2001/02. This is a gradual process.

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Country	Customer Name	Alert / Review Date	Currency Traded	HSBUS Purchase or Sale	USD Equiv Amount (in thousands)	Country Risk Rating	Client Risk (SCC)	Traders' Explanations & Follow-up Info requested/obtained by Compliance
URUGUAY	[REDACTED] = Redacted by the Permanent Subcommittee on Investigations	Feb-06	USD	P	\$15,000	Medium		This Central Bank is collecting the old notes from the local market and exporting them. They are planning to keep doing it and the goal is to clean the Uruguayan market of notes older than series 1996.
URUGUAY		Mar-05	USD	S	\$10,000	Medium		At the beginning of March a financial institution was suspended by the Central Bank originating some uncertainty on the market, and several Banks bought USD to be able to respond in the case that the public start to withdraw deposits from the system, a situation that finally didn't happen.
URUGUAY		Apr-06	USD	S	\$10,000	Medium		In general they do business with BOA but as we could provide them with a competitive rate they closed this deal with HSBC.
URUGUAY		Oct-06	USD	P	\$3,288	Medium		They export small denomination and used notes that they are not able to recirculate in the local market. The small denomination notes come from retail clients located in [REDACTED] it is not from any one particular client. If you analyze the activity of this client, they have only done two exports totalling around USD3MM each. Both these shipments were in denoms of 50s, 20s and 10s. These notes were accumulated over a period of 3 or 4 months and has no demand in the local market for these denoms. The preferred denom by clients is the \$100 denom. We so far did not encounter any major issue with USD counterfeits in Uruguay.
URUGUAY		Mar-07	USD	P+S	\$6M + \$9M	Medium		They sold an excess of small denomination and bad condition notes that they were not able to recirculate in the local market and then purchased new USD in 100s for replacing them.
URUGUAY		Aug-07	USD	P	\$6,665	Medium		They sold an excess of small denomination and bad condition notes that they were not able to recirculate in the local market and then purchased new USD in 100s for replacing them.
URUGUAY		Jan-08	USD	P	\$7,950	Medium		They sold an excess of small denomination and bad condition notes that they were not able to recirculate in the local market.
URUGUAY		May-08	USD	P	\$3,771	Medium		They sold an excess of small denomination and bad condition notes that they were not able to recirculate in the local market.
URUGUAY		Jul-08	USD	P	\$3,157	Medium		They sold an excess of small denomination and bad condition notes that they were not able to recirculate in the local market.
URUGUAY		Sep-08	USD	S	\$15,000	Medium		Due to the current financial crisis in the markets, and the consequently devaluation of the local currency, there is an increasing demand for USD banknotes in Uruguay as a way to keep the value of savings.

**BANKNOTES-NY Selected Customers' Activity Alerts & Traders' Explanations for USD Purchases & Sales from 2005-2009**

LCO reviews current & prior explanations from trader & client along with info in KYC profiles and recent activity for customer and country (in GBS) to confirm.  
 LCO uses independent sources (on internet) as needed to validate information provided by trader (tourism, remittances, trade, economic & political news/events, FX rates, GBS deal inquiry screens, etc.).  
 If variance (actual vs expected) appears potentially suspicious, LCO should research/investigate and report activity accordingly (internally & externally).

Country	Customer Name	Alert / Review Date	Currency Traded	HBUS Purchase or Sale	USD Equiv Amount (in thousands)	Country Risk Rating	Client Risk (BCC)	Traders' Explanations & Follow-up info requested/obtained by Compliance
URUGUAY	<div style="border: 1px solid black; padding: 5px; text-align: center;">                     [REDACTED] = Redacted by the Permanent Subcommittee on Investigations                 </div>	Oct-08	USD	S	\$72,000	Medium		Due to the international financial crisis and the economic uncertainty generated in Argentina's economy, as consequence of the reform of the Pension Funds announced by the government, there was a high demand for USD banknotes from people exchanging their savings in USD and withdrawing the money from the bank's account. Argentina and Uruguay have a highly integrated economy, they are both members of the MERCOSUR and historically the Uruguayan economy was related to Argentina. Uruguay's banking system has a higher reputation than the Argentinean one, and therefore, many wealthy Argentines have their savings deposited in Uruguay; therefore their client base is reacting not only to the international financial crisis but also to the added noise created by the Argentinean uncertainty, (as an example, Uruguay suffered a severe financial crisis in 2002 as a consequence of the Argentinean financial crisis in 2001)
URUGUAY		Feb-09	USD	P	\$13,616	Medium		They sold an excess of small denomination and bad condition notes that they were not able to recirculate in the local market. The months of Dec, Jan & Feb are the peak of the tourism activity in Uruguay and consequently there is a large amount of USD circulating in the country. Typically, the banks will try to use it to cover their own needs, and they will export the surplus.
URUGUAY		May-09	USD	P	\$4,118	Medium		They sold an excess of small denomination and bad condition notes that they were not able to recirculate in the local market.
URUGUAY		Aug-09	USD	P	\$5,524	Medium		They sold an excess of small denomination and bad condition notes that they were not able to recirculate in the local market.

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HSB000006995

Confidential & non-public OCC information

OCC-PSI-00005904



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**From:** Boss, Joseph  
**Sent:** Tuesday, June 22, 2010 6:36 PM  
**To:** Tabor, Teresa  
**Cc:** Boss, Joseph  
**Subject:** FW: HSBC  
**Attachments:** HSBC Initial [REDACTED] Contact.doc

FYI

---

**From:** Vivenzio, James  
**Sent:** Wednesday, July 29, 2009 5:24 PM  
**To:** Stipano, Dan; Belshaw, Sally; Dailey, Grace  
**Cc:** Boss, Joseph; De La Garza, Elsa; Wagner, John  
**Subject:** RE: HSBC

Here are my notes concerning my conversations with the [REDACTED] Agents. I will have [REDACTED] set up a meeting in Washington with everyone on this email, the two [REDACTED] Agents and [REDACTED]. I will also request that they put together some sort of a time line for us since this case goes back nearly two years.

Regards/JimV.

---

**From:** Stipano, Dan  
**Sent:** Wednesday, July 29, 2009 2:02 PM  
**To:** Stipano, Dan; Belshaw, Sally; Dailey, Grace  
**Cc:** Boss, Joseph; De La Garza, Elsa; Vivenzio, James; Wagner, John  
**Subject:** RE: HSBC

I spoke further with [REDACTED]. He wants to know if there is a U.S. supervisor for HSBC-Mexico. He also wants to know when we expect our exam to be completed. I told him I'd get back to him on these questions – please advise.

Separate from my conversations, Jim was contacted today by two [REDACTED] Agents who are also involved in the investigation. They provided Jim with additional information about particular accounts, etc., and requested a meeting with us. We should take them up on this.

From what I can tell, this has the makings of potentially being a major criminal case – we need to be all over it.

Jim, please weigh in here concerning the substance of the call you received.

*Daniel P. Stipano  
 Deputy Chief Counsel  
 Office of the Comptroller of the Currency*

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**From:** Stipano, Dan  
**Sent:** Wednesday, July 29, 2009 1:44 PM  
**To:** Belshaw, Sally; Dailey, Grace  
**Cc:** Boss, Joseph; De La Garza, Elsa  
**Subject:** RE: HSBC

[REDACTED] = Redacted by the Permanent Subcommittee on Investigations

Permanent Subcommittee on Investigations

EXHIBIT #38

Confidential & Non-public OCC Information

OCC-PSI-00928756

I think the important thing is that we take a close look at the Banknote area, which it sounds like we are doing. I would be particularly interested in the bank's level of due diligence on its Mexican customers, and a review of transaction activity involving those customers to ensure that the bank is satisfactorily identifying and reporting suspicious transactions. I will circle back to the [REDACTED] on this and let him know that we are in the process of conducting an examination of the Banknotes area right now. If he identifies any key areas for us to consider looking at, I'll pass them on.

*Daniel P. Stipano*  
Deputy Chief Counsel  
Office of the Comptroller of the Currency

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**From:** Belshaw, Sally  
**Sent:** Wednesday, July 29, 2009 1:30 PM  
**To:** Stipano, Dan; Dailey, Grace  
**Cc:** Boss, Joseph; De La Garza, Elsa  
**Subject:** FW: HSBC

As Joe indicates, we are in process of a review of this area now. The specific MRAs from our prior review had been cleared. If there is something we should do (or not do) as a result of this investigation, please let us know.

Regards, Sally

---

**From:** Boss, Joseph  
**Sent:** Wednesday, July 29, 2009 1:25 PM  
**To:** Belshaw, Sally  
**Cc:** Boss, Joseph; De La Garza, Elsa  
**Subject:** RE: HSBC

Sally,

We do not have supervisory responsibility for HSBC Mexico. The last Banknote examination encompassing the geographic area of Mexico was our "New York" Banknote examination which was conducted in 2005 (copy of Supervisory Letter attached). As you can see from the letter we had a number of MRA's involving consistent oversight of the KYC and EDD process, instances where the customer information, required by the bank's internal policies and procedures, was not obtained and/or the information obtained was not properly analyzed, instances in which profile information was either not obtained or the analysis of the information was inadequate, no monitoring had in fact occurred for those clients subject to conditional approval and the specific monitoring instructions of the BSA/AML Director, lack of identifying PEPs and that the current category of SCC clients does not account for the potential for reputation risk based on other adverse risk factors to include clients from jurisdictions that have, or clients who have, based on current events, become subject to enhanced regulatory, legal, media or other public scrutiny.

We are currently conducting a "New York" Banknote examination which includes Banknote clientele from the Mexico. If there is something that we should be doing to assist in matters, we can take the opportunity to do so during this current examination. If we are to take on some additional work during this examination, please let Elsa de la Garza know as she is acting EIC as I am on annual leave starting tomorrow.

Joe

— = Redacted by the Permanent  
Subcommittee on Investigations

**From:** Belshaw, Sally  
**Sent:** Wednesday, July 29, 2009 12:33 PM  
**To:** Boss, Joseph  
**Subject:** FW: HSBC

Joe: Let's discuss. Sally

---

**From:** Stipano, Dan  
**Sent:** Wednesday, July 29, 2009 12:32 PM  
**To:** Belshaw, Sally; Dailey, Grace  
**Cc:** Wagner, John; Vivenzio, James  
**Subject:** HSBC

Sally and Grace,

This morning I spoke to [REDACTED], an AUSA in the Eastern District of N.Y. [REDACTED] said that his office is in the early stages of investigating possible money laundering through the repatriation of U.S. currency through accounts at the banknotes division of HSBC-N.Y. The scheme that [REDACTED] described is similar to activity that we have seen at Union Bank, Wachovia, and Zions. Basically, the way it works is that drug money is physically hauled across the border into Mexico, then brought back into the United States through wire transfers from casas de cambio or small Mexican banks, or else smuggled across the border in armored cars, etc., before being deposited in U.S. institutions. According to [REDACTED] most U.S. banks, recognizing the risks involved, have gotten out of this business, but HSBC-NY is one of the last holdouts (although, interestingly, he said that HSBC-Mexico will no longer accept U.S. currency).

[REDACTED] wanted us to be aware of his investigation, but he also wanted to know: 1) whether the OCC has supervisory authority over HSBC-Mexico; and 2) whether we have done any recent examinations of the banknotes area at HSBC-NY (if so, he would like to see a copy of the ROE). I told him I didn't know the answers to his questions, but I would get back to him. Can you help?

Thanks,

Dan

*Daniel P. Stipano  
 Deputy Chief Counsel  
 Office of the Comptroller of the Currency*

— = Redacted by the Permanent  
 Subcommittee on Investigations

Permanent Subcommittee on Investigations  
EXHIBIT #39

## Conducting an Enhanced KYC for Grand Cayman Accountholders

*Proposal to Update the Strategy to Control  
Risk arising from Grand Cayman  
Accounts*

HSBC   
The world's local bank

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## Background

HBMX CEO requested to conduct an enhanced due diligence (KYC) for all Grand Cayman CDAs DDAs.

- ▶ The Bank has been recently fined for offering this product in Mexico, and money laundering red flags have been identified.
- ▶ On 28JUL, CMP gave instructions to suspend this product.
- ▶ On 31JUL08, Segment Directors were requested by CEO that an enhanced KYC will be completed for all Grand Cayman accounts before 01DEC08.
- ▶ As of JUL08, in Grand Cayman CDA/DDA product there were 49,937 customers, and its portfolio was approximately USD 1,500 million.
- ▶ Currently, this product is expected to be re-opened, as long as necessary adjustments to systems, processes and documentation are made, with stricter controls, and if Group Compliance's sign-off is obtained.
- ▶ On 26SEP, Segment Directors reported that almost no progress has been made in enhanced KYC completion. In addition, a central validation of enhanced KYC quality is not in place.
- ▶ According to Remediation Project results, success rate in file completion is approximately 25%. This means that if this strategy is followed, it will not be possible to complete more than 25 % of required enhanced KYC Forms by 01DEC08.

It is considered that it will not be possible to complete 50,000 enhanced KYC by 01DEC08

## Actions Taken Up to Date

The institution has taken mitigating actions for risk arising from this product.

- ▶ Implementing online controls to identify if customers are blacklisted people/ PEPs at HSBC account opening.
- ▶ Implementing a monthly control for customers who make cash transactions and USD transactions over USD100K.
- ▶ In order to re-open the product, it will be required to conduct an enhanced KYC of all new customers and cash deposits will be limited to USD 10K, for individuals, and USD 100K, for corporations.
- ▶ Updating Circulars and Work Instructions Manuals applicable to this product.
- ▶ Detailed Analysis of risk profile of approx. 50,000 Grand Cayman customers as shown in following slide:

**Existing Risk Arising From Grand Cayman Accounts**  
 Significant Risk degrees from Grand Cayman accounts is in 3341 customers, i.e., 6.69% of total customers.

Total Customer / Grand Cayman Accounts by Risk Degree			
Traffic Light	Description	Customers	Accounts
High Risk	SCCs, mainly customers reported to the authority (SARs) and/or with transactions over USD 100K.	1,314 (2.63%)	2,240
Medium	Customers with CAMP alerts (unusual transactions); but without SARs	2,027 (4.06%)	2,084
Low Risk	Customers with normal transaction profile, since alerts had not been generated by monitoring systems for them.	46,594 (93.31%)	57,262
	<b>TOTAL</b>	<b>49,935</b>	<b>61,586</b>

## High-Risk Customers - Present Status

Customers Group	Recommended Action	Customers 1,314	Accounts 2,240
Included in Remediation Efforts 2nd Phase	To continue with remediation efforts - 2nd phase for these accounts. By 30 OCT, it will be possible to find out the completion status.	342	1,137
Status 9 and 13	To close these accounts, once respective segments have confirmed it.	258	395
Included in Remediation Efforts 1st Phase	Completed Action: These accounts have already been purged, completed, automatically closed, or will be closed through Legal.	331	513
Not included in Remediation Efforts (I and II)	To conduct an Enhanced KYC by 31 OCT or close the account.	153	195

Compliance is currently working on the application of the same method to amber and white groups.



## Proposed Strategy

A risk-based strategy is proposed, which needs less resources

Total of Customers / Grand Cayman Accounts by Risk Level	
Traffic Light	Description
Red	<ul style="list-style-type: none"> <li>4 572 customer files are being prepared to be completed by 31OCT08, through Remediation Efforts 2nd phase (including central quality control)</li> <li>4 Incorporate 153 customers into this effort.</li> <li>4 To close immediately 258 customers with status 9 and 13.</li> </ul>
Amber	<ul style="list-style-type: none"> <li>4 To complete the examination of file completion status and follow a method similar to that developed for red traffic light.</li> <li>4 These files should be completed by 31OCT08.</li> </ul>
White	<ul style="list-style-type: none"> <li>4 Schedule the completion of these files for the Third Phase of Remediation Project, starting in NOV08.</li> <li>4 Apply a permanent monitoring to this universe so as to give priority to the files of those customers whose risk status may increase from time to time to amber/red traffic light.</li> <li>4 In addition, a control will be implemented to monitor risk associated with dramatic changes in transaction profile.</li> </ul>

## Strategic Options for Managing Grand Cayman Accounts Risk

Strategy	Advantages	Disadvantages
Continue with present strategy to complete an enhanced KYC for all accounts	<ul style="list-style-type: none"> <li>Remove all existing risk by closing all accounts of this product massively, effective from DEC08.</li> </ul>	<ul style="list-style-type: none"> <li>File Completion Progress will possibly be 25%, and as a result around 37,000 accounts will be closed.</li> <li>The funding from this product will be lost.</li> <li>There is not a dual control for checking enhanced KYC and file completion.</li> <li>It is not possible to complete enhanced KYC within established timescale.</li> </ul>
Risk-Based Strategy proposed in this document	<ul style="list-style-type: none"> <li>Implement a better risk control and Close high risk accounts immediately</li> <li>Incorporate this documentation into Remediation II</li> <li>More focused Work Load for branches.</li> <li>Dual Control for checking progress achieved in File Completion and Enhanced KYC Completion.</li> </ul>	<ul style="list-style-type: none"> <li>If enhanced KYC completion for white traffic light customers is deferred, a certain risk level will continue in place.</li> </ul>

HSBC-BNL\_E 0065711.txt

From: DENISE A REILLY/HBUS/HSBC  
 Sent: 5/25/2001 8:18:28 AM  
 To: CAROLYN WIND/HBUS/HSBC@HSBCAMERICAS; ANNE LIDDY/HBUS/HSBC@HSBCAMERICAS  
 CC:  
 Subject: BANK MELL

FYI

----- Forwarded by Denise A Reilly/HBUS/HSBC on 05/25/2001  
 09:16 AM -----

Michael B Gallagher @ REPUBLIC on 25 May 2001 00:54  
 Note  
 25 May 2001 00:54

From: Michael B Gallagher @ REPUBLIC Tel: 212-525-5680  
 Title: Executive Vice President Location: 452 5th Ave, Floor 5  
 WorkGroup:  
 Global Pymts and Cash Mgmt Mail Size: 45680

To: Denise A Reilly/HBUS/HSBC@HSBCAMERICAS

cc: Douglas Stolberg/HBUS/HSBC  
 Subject: BANK MELL

I wish to be on the record as not comfortable with this piece of business.

Michael

----- Forwarded by Michael B Gallagher/HBUS/HSBC on 05/25/2001  
 12:53 AM -----

Denise A Reilly @ HSBCAMERICAS on 22 May 2001 13:45  
 Note  
 22 May 2001 13:45

From: Denise A Reilly @ HSBCAMERICAS Tel: 302.636.2500  
 Title: Senior Vice President Location: Delaware  
 WorkGroup:  
 Payment Services Mail Size: 43118

To: Carolyn Wind/HBUS/HSBC@HSBCAMERICAS  
 Anne Liddy/HBUS/HSBC@HSBCAMERICAS  
 Michael B Gallagher/HBUS/HSBC@Republic  
 Subject: BANK MELL

Page 1

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Confidential Treatment

Permanent Subcommittee on Investigations

**EXHIBIT #40**

HSBC-PSI-PROD-0096138

756

HSBC-BNI\_E 0065711.txt

FYI

----- Forwarded by Denise A Reilly/HBUS/HSBC on 05/22/2001  
08:45 AM -----

Brian W RICHARDS@HSBC  
22 May 2001 05:32

To: Denise A Reilly/HBUS/HSBC@HSBCAMERICAS

cc: John R WILKINSON/HBEU/HSBC@HSBC

Peter C BLENN/HBEU/HSBC@HSBC

Subject: BANK MELLI

Denise

I refer to John Wilkinson's Email of 18MAY01.

I met Melli yesterday and enquired re names of the principal beneficiaries of their payments - as you will see from the attached Call Report, as expected, Melli could not assist.

Brian

Attachment: cl 20010521 BWR NH Sadeghifar Nazer Pourjam.doc.zip

Page 2

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HSBC-PSI-PROD-0096139

INSTITUTIONAL BANKING  
(CIB IBL)

CALL DATE: 21 MAY 01      CBID: BKDQ      CALL REPORT NO: 116184

---

BANK NAME: Bank Mellat Iran      PHONE: 0207 600 3636  
ADDRESS: 4 Moorgate      FAX: 0207 796 2152  
London  
EC2R 6AL

PARENT:  
GROUP RELATIONSHIP MANAGER: Chris Butcher

---

MARKETING CATEGORY: MLP      PLACE OF CALL: Restaurant, Vinters  
Place

---

## PERSON(S) CONTACTED AND TITLE(S):

1. Mr Ahmad Sadeghifar, Director General
  2. Majid Nazer, Head of Corporate Lending & Trade Finance
  3. Mr Saeed Pourjam, Cash and Payments Manager
- 

## HSBC GROUP CALLING OFFICERS:

1. Dr N Homapour, Iran Representative
  2. Brian Richards, Area Manager, Middle East & Africa, CIB IBL
  3. Phil Smith, HSBC Forfeiting
- 

## RELATIONSHIP/ACCOUNT PLAN OBJECTIVES:

1. Increase Trade Business with credit constraints
  2. Develop Treasury relationship within credit constraints
  3. Obtain an increase in account activity but not SSI
  4. Obtain CLS registration
- 

## CALL OBJECTIVES:

1. Discuss USD account
  2. Discuss forfeiting opportunities
- 

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HSBC-PSI-PROD-0096140

**NARRATIVE: (RELATIONSHIP INFORMATION, BUSINESS DEVELOPMENT\*, COMPETITION/OTHER ISSUES)**

**Business Development**

- USD account - draft proposal handed over for Melli perusal. Explained the Customer Charter would follow after negotiation with Melli management. OLAM explained, and stressed its use was unconditional to our offer. Was informed that total payment flow was nearer 300 per day, with USD 2 bio MMK. As expected, unable to answer HSUS enquiry re main beneficiaries - Iran imports from many countries and countless suppliers worldwide.
- Lloyds - BWR astonished to learn that Melli has moved most of its USD business from RBS to Lloyds, and has opened a treasury settlement account with Standard Chartered. However, still seem keen to use HSBC.
- CLS - not known by any Melli personnel present. Touched upon the structure and advantages of using HSBC, including the same portal interface as OLAM. Details sought.
- Melli London seek a "dedicated" silent confirmation line. Homapour indicated his support - JBL will process with FCC.

**Other**

- HSBC Tehran is establishing lines of credit for HKBA and HBAU re grain exports
- HSBC is progressing its plans to open a "virtual bank" in Kish offshore centre - opening planned for mid 2002. It remains a joint venture with NIC (in which Melli is a shareholder).

**PARENTAL SUPPORT/PERFORMANCE: (CAPITAL, ASSET QUALITY, MANAGEMENT, EARNINGS, LIQUIDITY)**

- Melli Bank plc will commence business end JUN01
- The new UK subsidiary will be the vehicle for a planned expansion into Euroland - Melli presently only has branches in Germany (2) and Paris
- The initial capital will be USD 300 mio

**ACTION:**

1. Revise Tender document - JW/GPCM
2. Establish invoice structure - JW
3. Prepare Customer Charter - JW
4. Send CLS details and place on mailing list - GPCM
5. Can we assist re "dedicated" London CCR line? - JW

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Confidential Treatment Requested

HSBC-PSI-PROD-0096141

759

**DISTRIBUTION:**

Daily circulation, J Richards, N Weir, Q Aylward, D Reilly, P Blenk

---

NEXT CALL DATE: 2H01	CALLING OFFICER: B W Richards
DATE OF THIS REPORT: 21 MAY 01	SIGNATURE:

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Confidential Treatment Requested HSBC-PSI-PROD-0096142

From: DENISE A REILLY/HBUS/HSBC  
 Sent: 7/12/2001 8:22:53 AM  
 To: DOUGLAS STOLBERG/HBUS/HSBC@HSBCAMERICAS  
 CC: JOE.HARPSTER@RNB.COM; MICHAEL B GALLAGHER/HBUS/HSBC@HSBCAMERICAS  
 Subject: Re: Bank Melli

The following memo is background information on the Bank Melli business, prepared by John Richards, Group Representative Iran. Additionally, in a conference call that Joe Harpster, Compliance and I had with HBEU and Richards on 6/27, it was relayed to us that the Group (with the backing of Bond) was looking to significantly grow our presence in Iran. Current lines of credit were reported to be \$800m, trade lines of \$150m and growth was anticipated in trade, cash management and internet banking. The Bank Melli clearing was viewed by Richards and others as not only profitable as a standalone but also key to winning additional business.

It should also be noted that at the time this proposition came to our attention, HBEU had already consulted with both Matthew King and external counsel and advised a comfort level from both quarters.

Given the seriousness of the business proposal, we continue due diligence on the transaction flow. The decision is primarily a Compliance/Legal one and we are working closely with them on the operational feasibility of any proposed transaction flow.

-----  
 From: John L RICHARDS/HSBL/HSBCAPAC Tel: 9821 204 0467  
 Mail Size: 4106

To: Brian W RICHARDS/MD3K/HSBC@HSBC  
 cc:

Subject: The Central Bank of Iran

Dear Brian

We have been approached by the Central Bank of Iran to take back their USD clearing business from NatWest. In principal I am keen to do this but on the clear proviso that it can be done profitably and on a sustainable basis.

One of our key objectives for the year is to develop HSBC's Asset Management activities in Iran and with the Central Bank now managing the oil price stabilization fund amounting to some USD10bn there is considerable scope for this. Obviously many foreign banks are chasing the same business and so we need to demonstrate some competitive or relational advantage. The proposal from the Central Bank was therefore not unwelcome.

I had an initial meeting with Mr Nowbehari Director Intl Dept of the Central Bank yesterday along with Nigel Weir who is visiting Tehran. I emphasised that if we were able to do this we would need to have detailed discussions so that we are clear what is required of us and what we require of them. The Central Bank manage their transactions through Bank Melli London and the intention would be that negotiations are held with Mr Sadeghtfar.

I would like to end up with a written agreement so that all parties are aware of what they are committing to. Although negotiating with Iranians is a frustrating activity we are in a strong position. They have become disatisfied with NatWest and with the exception of Lloyds, who will have the same issues we

Permanent Subcommittee on Investigations

EXHIBIT #41

Confidential - FOIA Treatment Req

.A. HSBC OCC 8876128



have there is little competition, I also assume that our technology advances will make the business more attractive than it was in the past.

I shall be grateful for your thoughts on this and your advice on how I should take this forward. Nigel is here until Thursday and if possible I shall be grateful for your initial feedback before he leaves so that I can discuss the matter further with him. I am sure that he will take this up with you himself but at the end of the day negotiations will be held in London and will be driven by you.

Nasser and I will be in the UK on Feb 14th 15th to help host a presentation to a number of Iranian Bank Managing Directors in association with Robert Gray and the investment bank. Subject to your views we can join any negotiation meetings that are arranged over that time.

In summary if we can make this business independently profitable and sustainable the benefits that we can derive particularly from the Treasury, Asset Management and Investment banking spin offs will be substantial. I want therefore to agree a strategy of how we go forward and who we involve before we make any further contact so that I am aware of all the issues involved.

I appreciate your help with this

Best regards

John

Douglas Stolberg  
11 Jul 2001 18:23

To: Denise A Reilly/HBUS/HSBC@HSBCAMERICAS

cc: Joe.Harpster@mb.com  
Michael B Gallagher/HBUS/HSBC@HSBCAMERICAS  
Subject: Re: Bank Mell

Denise and others,

With the amount of smoke coming off of this gun, remind me again why we think we should be supporting this business?

Doug

Denise A Reilly on 11 Jul 2001 17:16  
Note  
11 Jul 2001 17:16

From: Denise A Reilly Tel: 302.636.2500 Del  
Title: Senior Vice President Location: Delaware  
WorkGroup: Payment Services Mail Size: 33351

To: Douglas Stolberg/HBUS/HSBC@HSBCAMERICAS

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 8876129

cc: Joe.Harpster@rnb.com  
 Michael B Gallagher/HBUS/HSBC@HSBCAMERICAS  
 Subject: Bank Mell

This is an issue that you should be aware of. As described in Carolyn's memo, we have had ongoing discussions on the topic of Iranian payments both internally, with HBEU and with HBME IRN. HBUS Compliance and HBEU have also consulted with external counsel. The genesis for the discussion was an RFP for HBEU Treasury to handle Bank Mell's USD clearing. From an operational perspective, we will follow Compliance's direction as to whether we should support this business and if agreed, will establish any required operational controls.

Given the level of attention this is now getting, it may be raised at the SMC and will be included in the quarterly Compliance report.

I will keep you apprised.

----- Forwarded by Denise A Reilly/HBUS/HSBC on 07/11/2001

04:37 PM  
 Carolyn Wind on 11 Jul 2001 11:13  
 Note  
 11 Jul 2001 11:13

From: Carolyn Wind Tel: 212 525 5503  
 Title: Executive Vice President Location: 452 5th Ave, Floor 07  
 WorkGroup: RNYC Compliance Mail Size: 29302

To: Matthew J W KING/HGHQ/HSBC@HSBC

cc: Paul L Lee/HBUS/HSBC@HSBCAMERICAS  
 Anne Liddy/HBUS/HSBC@HSBCAMERICAS  
 Elizabeth Protomastro/HBUS/HSBC@HSBCAMERICAS  
 Denise A Reilly/HBUS/HSBC@HSBCAMERICAS  
 Subject: Bank Mell

Matthew, this e-mail is to summarize the issues we discussed yesterday regarding HBEU Bank Mell proposal. As you know, HBUS was initially approached in January 2001 with the proposal that HBEU would use its USD account with HBUS to clear USD payments for Bank Mell. Subsequently, there has been extensive review of the matter, including input from two outside US legal firms. The first issue was whether or not the underlying transactions originated by Bank Mell are permissible under the Iranian Transactions Regulations. The regulations provide a general license for transactions that meet the "U-Turn" definition and so we have gone back and forth as to whether the proposed underlying transactions meet the definition. (see below). There continues to be some disagreement between the advice from our two outside law firms on this point but we could probably resolve the difference. Of more concern is the second issue which is that given the way the payment orders are to be constructed and formatted, HBUS will not be able to confirm whether or not the underlying transaction actually meets the "U-Turn" requirement. It is not apparent that HBEU will be able to confirm that each payment meets the requirements. In an effort to facilitate "straight-through processing", it now appears that HBEU will train Bank Mell on formatting the payments and that we will be relying on Bank Mell to ensure that only qualifying payments are processed through HBEU's account with HBUS. (See attached letter to Bank

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Melli). If OFAC identifies a transaction that does not qualify, it might view HSBC's actions due to the non-disclosure as having involved willful disregard or evasion. Given the large dollar amounts and volume of activity proposed (300-400 transactions per day), if OFAC took such a view, potential liabilities could be substantial and would certainly impact HBUS's relationship with OFAC.

So to recap:

- A) Does this structure as proposed meet the U-turn requirement for processing? If Bank Melli and the second foreign bank do not appear on the MT202 processed by HBUS, how do we determine that the payment is in fact a U-turn?
- B) HBUS will not know the foreign banks and, therefore, will not be able to monitor for compliance. Will Melli be informing HBEU of the second foreign bank? Will HBEU set up a function to monitor these payments for compliance with the U-turn provision?
- C) If HBEU will set up a function to monitor the payments, it is possible that OFAC may not find it acceptable for HBUS to rely on HBEU to monitor payments for compliance with the U-turn.
- D) If the foreign banks involved are not disclosed on the MT202 processed by HBUS, and neither HBEU nor HBUS is monitoring the payments for compliance, OFAC could refer to the section of the regulation regarding "evasion" (Section 560.203 Evasions; attempts).

1) Definition of the permitted "U-Turn" transaction under the Iranian sanctions:  
The opinion received from outside counsel, Tom Crocker of Alston & Bird, on 2/2/01 in regards to the proposed transactions per Peter Blank's emails of 1/31/01 and 2/1/01 is quoted below.

"...the scenario outlined below does not appear to qualify for the so-called USD "U-turn" exception in the Iranian Transactions Regulations. Section 560.516(a)(1) of these Regulations provides a general license for dollar clearing functions which meet the following criteria: the transfer must be

(1) by a foreign bank which is not an Iranian entity (2) from its own account at a domestic bank (3) to an account held by a domestic bank (4) for a second foreign bank which is not an Iranian entity." Diagramming this out, the chain would look as follows:

Foreign Bank (non-Iranian) 1—Domestic Bank 1—Domestic Bank 1 or 2—Foreign Bank 2 (non-Iranian)

(The point of disagreement between legal firms is whether Foreign Bank 2 has to be a different bank from Foreign Bank 1. Our survey of other major USD clearing banks indicated that they follow the literal interpretation of the license, which is two different foreign banks involved.)

#### TRANSACTION DETAIL

Below are summaries of HBUS' understanding of the first proposed transaction flow and the latest proposal.

Example 1: U-TURN TRANSACTION

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## 1. Bank Meli sends instructions to HBEU to:

debit Bank Meli's account at HBEU  
credit HBEU nostro with HBUS

## 2. HBEU sends instructions to HBUS to:

debit HBEU account with HBUS  
credit any foreign bank (via a USA correspondent for the foreign bank)  
for further credit to the ultimate beneficiary

Note: Original HBEU suggestion on payment format would not mention Bank Meli as the originating bank

## Example II: Cover Payments (MT202 &amp; MT100)

## 1. Bank Meli, London sends instructions to HBEU to:

debit their account with HBEU and  
credit HBEU nostro with HBUS

## 2. HBEU will send an MT202 to HBUS to:

debit HBEU's account with HBUS  
credit any foreign bank (either on our books or via a USA correspondent for the foreign bank)

Note: Current HBEU recommendation on format would not mention Bank Meli but would contain some reference identification on the specific transaction being settled between Bank Meli and their customer.

3. HBEU will also simultaneously send an MT100 to the foreign bank (credit party) referenced in the above MT202, supplying them with beneficiary details for applying the funds received from HBUS

Note: The MT100 is often processed prior to the MT202 due to time differences between the US and the beneficiary's country.

3) HBEU Instructions to Bank Meli regarding how to format payments:  
See attached email of 28JUN01 from John R. Wilkinson with a copy of the letter sent to Bank Meli with instructions on how to format the SWIFT messages.

From: John R WILKINSON/HBEU/HSBC Tel: 790 44466  
44 20 7260 4466  
Mail Size: 23330

To: Denise A Reilly/HBUS/HSBC@HSBCAMERICAS  
cc: Joe.Harpster@rnb.com  
Anne Liddy/HBUS/HSBC@HSBCAMERICAS  
John L RICHARDS/HSBU/HSBCAPAC@HSBC  
Brian W RICHARDS/MDBK/HSBC@HSBC  
Quentin R AYLWARD/MDBK/HSBC@HSBC  
Terry J BELLAMY/MDBK/HSBC@HSBC  
Nick J GILLGRASS/MDBK/HSBC@HSBC

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Peter C BLENK/HBEU/HSBC@HSBC  
Subject: Re: Bank Melli

Per our conference call today, please find attached the letter 30APR01 sent by our Payments dept (MPD) to Bank Melli Iran London.

Once the proposition goes live we have instructed Bank Melli to alter the format of it's payments to achieve straight through processing. The field 52 input of 'One of our clients' is a standard phrase used by MPD in these situations.

Since sending the letter we have further asked them to only put 'One of our clients' in field 52, thus removing the chance of them inputting an 'Iranian referenced' customer name, that causes fall out of the cover payment sent to HBUS and a breach of OFAC regulations.

This method was successfully tested last month on a MT202 (bank to bank) and a MT100 (commercial) payment.

I can understand your concerns following the recent formatting error detailed in Peter Blenk's email 15JUN01, however I must provide some background for you.

MPD confirm that Bank Melli have not yet gone live on the new method of formatting payments, as we have not yet taken on the new business. Bank Melli are still formatting payments in their usual method, in this instance MPD failed to spot the poor input and did not follow their normal procedure of altering the payment, hence it was blocked. MPD have again confirmed the new formatting method will achieve straight through processing and overcome these difficulties.

I hope the above detail is sufficient for your purposes and you are able to progress this matter forward as intimated in your earlier approval.

Attachment: rl 20010501 fm MPD to BKBG re formatting.doc.zip

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Saeed Pourjam  
Bank Melli Iran  
4 Moorgate  
London EC2 6AL

30/04/01

Dear Saeed,

I refer to our meeting last month and our telephone conversation of today. I am pleased to advise that following tests in our payments environment we are confident that we have found a solution to processing your payments with minimal manual intervention.

The key is to **always** populate field 52 – if you do not have an ordering party name then quote "One of our Clients". **never leave blank**. This means that the outgoing payment instruction from HSBC will not quote "Bank Melli" as sender – just HSBC London and whatever is in field 52. This then negates the need to quote "DO NOT MENTION OUR NAME IN NEW YORK" in field 72.

In order to test our proposed solution we would appreciate if used the following templates when submitting your next payments to the following customer, or alternatively submit a USD 1 test payment.

MT202

20: *Your Ref....*

21: *Related Ref....*

32: *Amount/Currency/Value date....*

50: **DO NOT QUOTE IF IRANIAN**

52: *Customer Name OR One of our clients* **MUST BE COMPLETED**

53: **/68296908**

54:

56:

57: *Beneficiary Banker (SWIFT codes where possible)*

58: *Beneficiary (SWIFT codes where possible)*

70: *Any Payments details for beneficiary....*

72: **Please leave blank**

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MT100

Pay as above.

In order for us to monitor / track these payments please call Adrian Taylor prior to release on 020 72604180. Please use SWIFT standards, Adrian will be happy to discuss with your operator any questions they have re formatting.

When we have made these payments we can then give feedback on any further formatting issues.

Thank-you in advance for co-operation.

Yours sincerely

John Fowle

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From: Susan A WRIGHT  
 Sent: Thu Oct 11 09:29:24 2001  
 To: John ALLISON  
 Subject: Re: OFAC SANCTIONS  
 Importance: Normal  
 Attachments: image\_0.gif; image\_1.gif; Doc Link.htm

John - FYI

Forwarded by Susan A WRIGHT/HQHQ/HSBC on 11 Oct 2001 09:27

General Letter

10 Oct 2001 23:02



From: Matthew J W KING/HQHQ/HSBC

Tel: 760 56815

6241 5029 12743

David W BAGLEY et al

To: David W J BAGLEY/RLA LGA MEM/BBME/HSBC

cc: Susan A WRIGHT/HQHQ/HSBC@HSBC

Mark P TAYLOR/SM CMP APH/HBAP/HSBC@HSBC

Our Ref: Your Ref: MEM LGA  
 012354

Subject: Re: OFAC SANCTIONS

David,

I will forward to you separately a note I sent to Mark Taylor which I hope may clarify things to a certain extent.

The position is difficult because things have changed since September 11. We also have to bear in mind pending US legislation which will in effect give the US extra-territorial authority over foreign banks, particularly if we are unfortunate enough to process a payment which turns out to be connected to terrorism. My own view therefore is that some of the routes traditionally used to avoid the impact of US OFAC sanctions may no longer be acceptable. I appreciate however that the solution will involve the installation of some form of automated screening system. We are looking into this now. Until this is resolved, all we can do is to ask that payments from the affected countries

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HSBC OCC 8873890

are vetted manually. This is not easy and I agree we should talk about it in more detail on Monday.

I look forward to speaking to you then.

Regards

Matthew King

David W J BAGLEY



General Letter

10 Oct 2001 13:29

Sent by: Aileen A MAROLIA

Matthew J W KING et al

To: Matthew J W KING/HQHSBC@HSBC  
cc: Susan A WRIGHT/HQHSBC@HSBC  
Mark P TAYLOR/SM CMP AP/HQHSBC@HSBC  
From: David W J BAGLEY/RLA LGA MEM/BBME/HSBC 071 4 5077597

Our Ref: MEM LGA Your Ref:  
012354

Subject: OFAC SANCTIONS

Matthew,

In the light of the current attention being given to the applications of relevant sanctions I feel that there is some need to clarify precisely what is expected of operations within my region in relation to the application of OFAC Sanctions when dealing in USD payments. I do this solely from the perspective of avoiding any misunderstanding.

A number of the OFAC sanctions could have potential effect upon business in this

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Region, the most obvious of which are those relating to Iran, Libya and Sudan. As these are US Sanctions, binding US persons they do not have the same effect as the UN Sanctions against Iraq, and on the face of it do not bind either HBME's activities, or those of our customers in any of the above jurisdictions.

I recognise however that the sanctions do affect all transactions in USD, and that payments passing through the US are capable of being identified by the OFAC filters. Even if those transactions involve say an HBME UAE based customer, if there is a connection with one of the above jurisdictions it is likely that the payment will be frozen pending further investigation by OFAC itself.

There are of course risks for us if such a payment is frozen, particularly if the monies are frozen as between correspondent banks, and yet we have shown a credit to the customers USD account here in the Middle East. In the past we have been obliged to pursue a release of monies which have been released to a customer, but have been frozen through the correspondent banking system in the US.

What I am currently unclear about however is the extent to which we are expected to police and observe the OFAC sanctions when dealing in transactions for our customers. Recent notes seem to suggest that we should apply the OFAC Sanctions regardless of jurisdiction.

As I understand the current position we do routinely, and across the Group, adopt differing approaches to payments potentially subject to OFAC sanctions, than to those payments that are unaffected.

This is achieved by a number of different methods.

What I am unclear about is whether these procedures is viewed as being inappropriate, and thus should be disallowed. We do not structure these payments against a specific request from the customer, rather we undertake this structuring as a routine. I am advised that there may even be software in the UK which filters such payments for restructuring in the event that the original message has been structured in such a way that it will be caught by the OFAC filters.

Were we to disallow all payments which are potentially subject to the OFAC process, or forward messages in such a way that they would be caught, then clearly this would have a significant affect upon our business within the Middle East, but also the Group's business within correspondent banking.

Equally given the likely volumes it is impractical to submit each payment to a process of referral to HBSU.

I would be grateful for your clarification as to whether what is currently going on is acceptable, or whether we should be adopting a different practice.

I recognise that with regard to sanctions which clearly bind HBME (e.g. - Iraq) we have no choice other than to ensure that sanctions are observed, that we undertake no transactions which are potentially caught by the sanctions, other than those permitted on the food for oil basis.

I have separately resolved the issue of EU sanctions, which would theoretically bind HBME as an EU person, where we have confirmation that to observe the sanctions within UAE would place the bank at risk of double jeopardy.

I apologise for the length of the note, but having spoken to Mark Taylor both of us are a little unclear as to how far we are expected to observe sanctions which are non-binding in our jurisdictions in the current climate.

David

HSBC-BN1\_E 0065949.txt

From: ANNE LIDDY/HBUS/HSBC  
 Sent: 10/21/2002 8:30:40 AM  
 To: CAROLYN M WIND/HBUS/HSBC@HSBCAMERICAS  
 CC: DENISE A REILLY/HBUS/HSBC@HSBCAMERICAS  
 Subject: IRAN

Carolyn, I just spoke with Denise. We have tentatively set a date of Friday 10/25 at noon to call Gary Boon on his home number re Bank Melll. Will you be available? Thanks.

----- Forwarded by Anne Liddy/HBUS/HSBC on 10/21/2002 09:34 AM

Anne Liddy on 18 Oct 2002 09:35

Note  
 18 Oct 2002 09:35

From: Anne Liddy Tel: 212-525-5906  
 Title: Senior Vice President Location: 452 5th Ave, Floor 07  
 WorkGroup: Corporate Compliance Mail Size: 55201

To: Denise A Reilly/HBUS/HSBC@HSBCAMERICAS  
 Carolyn M Wind/HBUS/HSBC@HSBCAMERICAS  
 Subject: IRAN

I don't really know what else I can tell Gary that has not already been discussed...but anyway I guess I need to set up a call. Could you both join me, please what times would be good for you on Monday?

----- Forwarded by Anne Liddy/HBUS/HSBC on 10/18/2002 09:34 AM

Gary BOON @ HSBC on 17 Oct 2002 08:11

Note  
 17 Oct 2002 08:11

From: Gary BOON @ HSBC Tel:  
 Title: Location:  
 WorkGroup: Mail Size: 2138

To: Anne Liddy/HBUS/HSBC@HSBCAMERICAS  
 Subject: IRAN

Anne, the GRM and I are booked to visit Iran in November and ideally want our position sorted re USD payments. I'm therefore getting eager to talk to you as if we can there are massive opportunities.

It appears London and Iran are seeking a solution to this so you help is much appreciated.

It is the weekend Thursday and Friday here but I'm more than happy to talk to you either tonight or tomorrow. Call me at home at between 12 noon & 1pm your time on 00 971 4 3481559 if you can.

If not can we make it Monday?

Regards

Gary

Anne Liddy on 09 Oct 2002 08:24

Note  
 09 Oct 2002 08:24

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HSB08071277

HSBC OCC 7687373

HSBC-BNL\_E 0065949.txt

From: Anne Liddy Tel: 212-525-5906  
 Title: Senior Vice President Location: 452 5th Ave, Floor 07  
 WorkGroup: Corporate Compliance Mail Size: 6657

To: Gary BOON/MGR PCM MEM/HBME/HSBC@HSBC

cc: Carolyn M Wind/HBUS/HSBC@HSBCAMERICAS  
 Denise A Reilly/HBUS/HSBC@HSBCAMERICAS  
 Nancy Hedges/HBUS/HSBC@HSBCAMERICAS  
 Paul PROCTOR/HBUS/HSBC@HSBC  
 Subject: Re: Bank Mell

Gary, I have a mtg already scheduled for 9am NYC time today. I will try to set up a call for another day/time and get back to you.

Gary BOON @ HSBC on 08 Oct 2002 23:53

Note  
 08 Oct 2002 23:53

From: Gary BOON @ HSBC Tel:  
 Title: Location:  
 WorkGroup: Mail Size: 2797

To: Anne Liddy/HBUS/HSBC@HSBCAMERICAS

cc: Carolyn M Wind/HBUS/HSBC@HSBCAMERICAS  
 Denise A Reilly/HBUS/HSBC@HSBCAMERICAS  
 Nancy Hedges/HBUS/HSBC@HSBCAMERICAS  
 Paul PROCTOR/HBUS/HSBC@HSBC  
 Subject: Re: Bank Mell

Gary BOON @ HSBC on 08 Oct 2002 23:53

Note  
 08 Oct 2002 23:53

From: Gary BOON @ HSBC Tel:  
 Title: Location:  
 WorkGroup: Mail Size: 2797

To: Anne Liddy/HBUS/HSBC@HSBCAMERICAS

cc: Carolyn M Wind/HBUS/HSBC@HSBCAMERICAS  
 Denise A Reilly/HBUS/HSBC@HSBCAMERICAS  
 Nancy Hedges/HBUS/HSBC@HSBCAMERICAS  
 Paul PROCTOR/HBUS/HSBC@HSBC  
 Subject: Re: Bank Mell

Anne, thanks for the update.

As your aware HBU have to comply with the FATF regulations soon, which means full disclosure for all MT100/MT103 payments from all banks.

As my previous e-mail explained these payments would then be sent to HBU for processing (examples of the types of instructions you're receive have been sent previously) and it is my belief that they will full into the normal OFAC process. Your already processing USD payments from two existing accounts held

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775

in London

HSBC-BNL\_E 0065949.txt

The majority of payments will be processed with HBEU sending a MT100/MT103 to the beneficiary bank and HBUS will receive the MT202 cover payment (again your already doing this).

Can I suggest that I call you today to discuss this further at 9am your time? Can you set up a conference call that interested parties (in cc above) can join in? If it's too short notice please advise me of a convenient time/date (1'm 8 hours ahead).

Regards  
Gary

Anne Liddy on 08 Oct 2002 15:55  
Note  
08 Oct 2002 15:55

From: Anne Liddy Tel: 212-525-5906  
Title: Senior Vice President Location: 452 5th Ave, Floor 07  
WorkGroup: Corporate Compliance Mail Size: 48218

To: Gary BOON/MGR PCM MEM/HBME/HSBC@HSBC

Cc: Carolyn M Wind/HBUS/HSBC@HSBCAMERICAS  
Denise A Reilly/HBUS/HSBC@HSBCAMERICAS  
Nancy Hedges/HBUS/HSBC@HSBCAMERICAS  
Paul PROCTOR/HBEU/HSBC@HSBC

Subject: Bank Melll

Gary, I understand from Nancy Hedges that you are looking for feedback on the Bank Melll proposal. The position of HBUS Compliance remains unchanged re this proposal in that all transactions involving Bank Melll must be fully disclosed and represented in one single transaction that reflects the complete flow of funds. Full disclosure will allow the HBUS payments filter to stop the USD transactions involving Bank Melll and will allow for review of the transaction by HBUS Payment Operations staff to ensure that the transaction fits the definition of a U-turn transaction allowable for processing under the U-turn exemption of the OFAC Iranian sanction.

It is still my understanding that the document attached below (see email from Denise Reilly dated August 29, 2001) is the operative document that outlines the operational process and transaction flows. The transaction flows were approved by Legal Counsel as fitting the U-turn exemption requirements. The next step was that the operational process must be agreed between HBUS Payment Operations and HBEU Payment Operations. At which point, prior to making any proposal to Bank Melll (or any other Iranian banks) HBUS Compliance must inform OFAC and our Senior Management Committee of the proposal and the agreed upon operational procedures.

----- Forwarded by Anne Liddy/HBUS/HSBC on 10/08/2002 03:13 PM

Nancy Hedges on 08 Oct 2002 14:45  
Note  
08 Oct 2002 14:45

From: Nancy Hedges Tel: 302-636-2333

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HSBC-BN1\_E 0065949.txt  
 Title: First Vice President Location: Delaware, Floor 3rd floor  
 WorkGroup: Funds Transfer Mail Size: 43230  
 To: Anne Liddy/HBUS/HSBC@HSBCAMERICAS  
 Subject: Bank Mell1

----- Forwarded by Nancy Hedges/HBUS/HSBC on 10/08/2002 02:46

PM -----  
 Denise A Reilly on 16 Jul 2002 09:04

Note  
 16 Jul 2002 09:04  
 From: Denise A Reilly Tel: 302.636.2500 Del  
 Title: Senior Vice President Location: Delaware  
 WorkGroup: Payment Services Mail Size: 42022

To: Nancy Hedges/HBUS/HSBC@HSBCAMERICAS  
 Subject: Bank Mell1

This should be the operative document for discussion. Due to increased regulatory controls in the UK, any previous proposals by them are no longer operative.

----- Forwarded by Denise A Reilly/HBUS/HSBC on 07/16/2002

09:04 AM -----  
 Denise A Reilly on 15 Apr 2002 19:10

Note  
 15 Apr 2002 19:10  
 From: Denise A Reilly Tel: 302.636.2500 Del  
 Title: Senior Vice President Location: Delaware  
 WorkGroup: Payment Services Mail Size: 40684

To: John R WILKINSON/HBEU/HSBC@HSBC  
 John FOWLE/HBEU/HSBC@HSBC  
 Geoffrey P WEASER/HBEU/HSBC@HSBC  
 Adrian TAYLOR/HBEU/HSBC@HSBC  
 Nancy Hedges/HBUS/HSBC@HSBCAMERICAS  
 Stephen A Tedeschi/HBUS/HSBC@HSBCAMERICAS  
 Subject: Bank Mell1

In preparation for our meeting this week, attached is the Bank Mell1 transaction flow that was previously put forward and subsequently agreed to by John Richards. Since this has been "vetted" by legal counsel it should form the basis for our discussion.

Will speak to you on Wednesday.

----- Forwarded by Denise A Reilly/HBUS/HSBC on 04/15/2002

07:05 PM -----  
 Denise A Reilly on 29 Aug 2001 19:23

Note  
 29 Aug 2001 19:23  
 From: Denise A Reilly Tel: 302.636.2500 Del  
 Title: Senior Vice President Location: Delaware  
 WorkGroup: Payment Services Mail Size: 37527

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 Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSB0007687376



777

HSBC-BNIE 0065949.txt

To: Alan WILKINSON/HD HTV ASP/HBAP/HSBC@HSBC  
Quentin R AYLUWARD/MDBK/HSBC@HSBC

cc: Carolyn M Wind/HBUS/HSBC@HSBCAMERICAS  
Matthew J W KING/HQHQ/HSBC@HSBC  
Elizabeth Protomastro/HBUS/HSBC@HSBCAMERICAS  
John L RICHARDS/HSBL/HSBCAPAC@HSBC  
Subject: Bank Melli

The attached document reflects the procedures that have been developed, with the advise and consent of legal counsel, to support Bank Melli payments through HSEU/HBUS. The procedure is designed to meet both regulatory and service quality requirements. Assuming that transactions sent to HBUS meet the u-turn qualifications, all transactions will be processed same day of receipt.

On Thursday of next week (6 September) we will be meeting with the Director of the Office of Foreign Assets Control and one of the agenda items is to determine their position regarding this business. In anticipation of that meeting, Carolyn Wind and I would appreciate your reviewing the document and if possible meeting with us tomorrow, 10 a.m. NY time/3 p.m. London time, via conference call to discuss. Please confirm your availability and a number where you can be contacted.

Attachment: Melli.doc.zip

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HSBC-BNI\_E 0066016

From: ANNE LIDDY/HBUS/HSBC  
 Sent: 1/21/2003 1:00:08 PM  
 To: "CROCKER, TOM" <TCROCKER@ALSTON.COM>  
 CC: CAROLYN M WIND/HBUS/HSBC@HSBCAMERICAS; DENISE A REILLY/HBUS/HSBC@HSBCAMERICAS; ELIZABETH PROTOMASTRO/HBUS/HSBC@HSBCAMERICAS  
 Subject: USD Payments from Iranian Banks

Tom,

At Carolyn Wind's request I am forwarding the attached memo to you for your review and comments. As you may recall, it was agreed that our London/Middle East office would put together a business case regarding plans for providing USD payment services to Iranian Banks (stemming from an initial request for HSBC Bank USA to process USD payments for Bank Mellat). This memo outlines that business case. After you have reviewed and provided us with your comments, which may require amendments to the business case, HSBC Bank USA had intended to present the business case to our Senior Management Committee prior to acceptance of the plan. We appreciate your attention to this matter and look forward to hearing from you on this much discussed topic. Thank you.

Regards,  
 Anne Liddy  
 HSBC Bank USA  
 Compliance Department

----- Forwarded by Anne Liddy/HBUS/HSBC on 01/21/2003 11:00 AM

Denise A Reilly on 16 Jan 2003 09:19  
 Note  
 16 Jan 2003 09:19

From: Denise A Reilly Tel: 302.636.2500 Del  
 Title: Senior Vice President Location: Delaware  
 WorkGroup: Payment Services Mail Size: 243262

To: Anne Liddy/HBUS/HSBC@HSBCAMERICAS  
 Carolyn M Wind/HBUS/HSBC@HSBCAMERICAS  
 Subject: USD Payments from Iranian Banks

I'm not sure why you were not cc'd on this, but I am forwarding for your review. Perhaps we can discuss tomorrow when I'm in NYC.

----- Forwarded by Denise A Reilly/HBUS/HSBC on 01/16/2003

09:20 AM -----  
 From: Nigel J WEIR@HSBC on 16 Jan 2003 03:56

To: Denise A Reilly/HBUS/HSBC@HSBCAMERICAS  
 Malcolm G EASTWOOD@HSBC

CC: Nasser HOMAIPOUR/HSBL/HSBCAPAC@HSBC  
 Nigel J WEIR/RM IB MEM/HBME/HSBC@HSBC  
 Gary BOON/MGR PCM MEM/HBME/HSBC@HSBC  
 James J Y MADSEN/HBEU/HSBC@HSBC  
 Subject: USD Payments from Iranian Banks

Denise,

Attached is our business case signed by Rick Pudner, seeking HBUS's approval to process USD payments originating from Iranian Banks. There has been a great deal of correspondence relating to this issue over the past 2 years so we hope this document will precipitate a positive resolution.

Permanent Subcommittee on Investigations

EXHIBIT #44

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js, Inc. HSB03793152  
 HSBC OCC 3407510

779

Kind Regards  
Nigel

HSBC-BNI\_E 0066016

Attachment: Iran business case.doc.zip

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HSBC Bank Middle East

Memo

To Denise Reilly, Senior Manager, Operations, HBUS Malcolm Eastwood, Senior Manager, Operations, HBEU		Date January 2003
From Rick Pudner, Head of CIB, Middle East, Dubai		Sender's Reference
CC Dr Nasser Homapour, Iran Representative, Tehran Nigel Weir, GRM, Middle East, Dubai Gary Boon, Global Payments & Cash Mgmt, Dubai James Madseu, Global Payments & Cash Mgmt, London		
Subject <b>BUSINESS CASE – USD PAYMENTS FROM IRANIAN BANKS/ENTITIES</b>		Receiver's Reference
To Facsimile No.	From Facsimile No.	Total No. of pages

**Executive Summary**

This paper has been produced in order for the Senior Management Committee (SMC) of HSBC Bank USA (HBUS) to evaluate whether or not HBUS will process US dollar (USD) payments initiated by Iranian Banks via accounts held with HSBC Bank Plc (HBEU), using the process provided to HBEU by HBUS dated 29 August 2001. This operational process may be amended at any time and HBEU will be required to adhere strictly to the new procedures as advised by HBUS.

Currently, it is estimated that Iranian banks issue up to 700 USD payments a day using their USD service providers, mainly banks in the UK and Europe, which in turn use their New York USD correspondents to effect the payments. It is believed that some service providers amend the payments to ensure Iran is not mentioned in the body of the payment instruction to their USD correspondent. This process minimises the risk of payments being referred to OFAC.

Institutional Banking and PCM believe there is a substantial income opportunity to sell a USD payments proposition to Iranian Banks in view of the impending FATF regulations, which are due to become effective in Q2 2003. The new regulations dictate that each bank (effecting the payments on behalf of their clients) within each FATF member country must ensure the full name, address and account number of the ordering party are quoted on the payment instructions. This increases the risk of Iranian payments being held in the USA as they may fall foul of the OFAC regulations. The Iranian Banks have now prioritised this issue and are now actively seeking a solution from their banks, including HSBC.

We believe that HSBC could offer the Iranian Banks a solution that facilitates a way for them to effect USD payments to beneficiaries outside the USA using the 'U-Turn' process documented within the OFAC regulations for Iran. HBUS have already provided HBEU with their operational requirements to process these U-Turn payments and therefore SMC approval is being sought prior to HBEU scoping potential IT changes and the production of a service proposition for the Iranian Banks. This business case also highlights the potential risks should approval not be given.

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### Background

Iran Representative office was formally opened on 11th of November 1999. Following the establishment of the office the volume of business between Iranian banks / companies and Group offices has been increasing all the time. The Group now has an excellent relationship with all Iranian banks and some very large Iranian corporates such as National Iranian Oil Co, National Petrochemical Co, National Iranian Gas Co, National Iranian Steel Co, top Iranian insurance companies, Ministry of Power, Ministry of Post and Telecommunications etc.

About 80% of Iran's foreign trade, totalling USD25 billion, is denominated in USD. Iran undertakes a considerable volume of trade in markets in which HSBC is represented, enabling the Group to leverage its global footprint. Our Iran Representative office has worked hard over the past three and a half years to build a positive image of Iran through road shows, visits, supporting trade missions and by referring good Iranian business to Group offices. This has shown HSBC to its customers as a bank that is able to do business in difficult markets and as a result added considerable value to the Group. Strategically, Iran is the country in the Middle East region with the most development potential for HSBC in the long term. It has the world's fifth largest oil reserves, second largest gas reserves, substantial mineral reserves and a large well educated population.

The Iran Representative office was established to develop relationships and credibility for HSBC in the market. This objective has been achieved and the Group is well placed to develop its operation from a position of considerable goodwill. Details of HSBC's business with Iran and Iranian entities are shown in Appendix 1.

### Opportunity

The FAFT regulations are due to be implemented in Q2 2003 and will force banks, within the FAFT countries, to disclose all details of the ordering and beneficiary parties, effectively ending the practice currently undertaken for Iranian payments. The Iranian banks have yet to hear from their existing providers, mainly Lloyds Bank and Standard Chartered Bank, and we believe there is currently a window of opportunity.

However, during the past two years, HBEU and HBUS have been in discussions about how we can process these transactions, identifying the operational processes and compliance issues involved. After meetings with OFAC and external counsel, HBUS has produced a payments process. It will be scoped by HBEU, subject to SMC approving this paper, in order to identify their operational, compliance and IT issues before providing Sales with a service proposition.

HBEU / HBUS have identified that by using the 'U-Turn' payment method, Iranian banks can effect transactions to beneficiary accounts outside the USA. This method will allow HBEU to send HBUS payment instructions with Iranian entities quoted on the instructions and yet at the same time be compliant with FATF and OFAC guidelines. The proposed service proposition will provide a suitable disclaimer to ensure HSBC is not held liable for any payments which have not met the 'U-Turn' criteria and as a result been referred to OFAC.

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**Benefits**

- Payment volumes are estimated at 700 per day of which 70% will be commercial payments. Transaction income is estimated at USD4M, assuming that HSBC wins all the business at an average item price of USD30. We believe that charges being levied by other banks at the moment are far higher than this.
- Balance income in HBEU.
- Reputation within Iran and the potential to leverage additional business.

**Risks If Approval Declined**

- If HBUS declines to process these transactions, then consideration will need to be given to closing all existing Iranian bank USD accounts with the HSBC Group.
- Should the above occur the current Group annual income of USD2M from Iranian Banks will be under threat.
- The market will perceive that HSBC does not support Iranian business
- The adverse impact on our Representative office in Tehran.

**Summary**

It is anticipated that Iran will become a source of increasing income for the Group going forward and if we are to achieve this goal we must adopt a positive stance when encountering difficulties. We are aware of the concerns expressed by HBUS but strongly believe that by working together we can overcome them using means which are perfectly legitimate and in accordance with rules laid down by the relevant regulatory bodies. I hope we will be able to resolve this issue otherwise I fear we will destroy future value in a market which has substantial potential for the Group.

It will be appreciated if you could raise this paper to your SMC at the earliest opportunity and advise me of the decision as soon as possible.

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## Appendix 1

## 1- Medium Term Project Finance Line - Various Group Offices. USD500M.

This line covers a number of individual ECA backed project finance loans. It is denominated largely in USD. The facility requires that Iranian banks effect regular USD repayments. So far under this facility USD35M is utilised. HSBC now has a mandate from National Petrochemical Co. and Technip of France for USD155M to arrange financing for Olefine 9 project. Two other projects, one for USD145M for Styrene Monomer out of the UK and one for USD170M out of Japan will be financed by HSBC through structured finance outside the above line. The latter, for Mitsui with JBIC cover is already finalised and the other one is near completion. The provisioning for Iran has been reduced to 5% in December 2002, which will make it easier for HSBC to undertake more projects in Iran in the near future. With this in mind HSBC Project and Export Finance have decided to increase the above line to USD1bn.

2- Short Term Trade Refinancing Agreement - HBME Dubai USD50M, BACB USD25M. These lines are denominated in USD and require the USD loans to be booked at HBME Dubai or BACB London.

3- Wheat Finance lines with HSBC Australia USD50M and HSBC Canada USD100M.

## 4 - L/C's Issued for Iranian Companies Abroad - Various Group Offices.

HSBC offices are developing relationships with Iranian Government and non - Government companies. The L/C's issued are normally denominated in USD. Following NIOC's acceptance of HSBC as one its listed banks, HSBC Bank Middle East now handles Iran's oil export related L/C's. Turnover for this business is about USD400M per year.

## 5 - USD Clearing Accounts.

HSBC Bank plc has a number of existing USD accounts for Iranian banks, which are used for payments clearing purposes.

## 6 - Treasury and Capital Markets

HSBC Investment bank has transacted in excess of USD1bn of Bond business with Iran generating an income of over GBP700k in 2002. HBME Dubai and HSBC Markets operate active foreign exchange and money market lines with the Central Bank of Iran and Iranian banks.

## 7 - Potential Business

a- HSBC is actively pursuing an Asset Management mandate with the Central Bank which will require USD payments to be paid and received.

b- Iran has entered the capital market for the first time in 20 years, issuing USD1bn worth of paper through the Central Bank. The budget for the next year is USD 2bn with some to be issued in Islamic form. HSBC has a very good chance of being nominated to lead manage part of the conventional issue and a good chance of being nominated for the Islamic issue. Both require USD payments to be paid and received.

c- HSBC may form an Internet Bank in Iran, which will require an active USD payment capability.

The key thing to note is that all existing and potential business involves a regular and substantial flow of USD payments both in and out.

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From: Nigel J WEIR  
 Sent: Mon Feb 03 13:44:14 2003  
 To: David W J BAGLEY  
 Cc: Rick A PUDNER; Jb BLANTHORNE; Nasser HOMAPOUR; John F ROOT  
 Subject: Memo; Re: BUSINESS CASE - US PAYMENTS FROM IRANIAN BANKS/ENTITIES  
 Importance: Normal  
 Attachments: image\_0.gif

David,

As I prepared the majority of the business case I think it is appropriate that I respond on behalf of Rick.

Firstly, I would like to stress that under no circumstances am I suggesting that the HBUS is acting or should in future consider acting improperly. Indeed I have specified on more than one occasion that we must be in full compliance with OFAC, FATF and other regulatory bodies.

3rd paragraph of the section headed Opportunity:

**"This method will allow HBEU to send HBUS payment instructions with Iranian entities quoted on the instructions and yet at the same time be compliant with FATF and OFAC guidelines"**

1st paragraph of the section headed Summary:

**"We are aware of the concerns expressed by HBUS but strongly believe that by working together we can overcome them using means which are perfectly legitimate and in accordance with rules laid down by the relevant regulatory bodies."**

In simple terms the aim of this business case was to recommend that we need to try and take advantage of a significant business opportunity whilst at the same time actively complying with regulations laid down by various regulatory bodies.

Kind Regards

Nigel

03Feb2003

Memo



Sent by: Marlon O ROACH

To: Rick A PUDNER/HD CIB MEM/HBME/HSBC@HSBC et al

To: Rick A PUDNER/HD CIB MEM/HBME/HSBC@HSBC  
 Jb BLANTHORNE/CEO SEL/HBAP/HSBC@HSBC

Permanent Subcommittee on Investigations  
**EXHIBIT #45**

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A. HSBC OCC 8876487



cc: Nasser HOMAIPOUR/HSBL/HSBCAPAC@HSBC  
Nigel J WEIR/RM IB MEM/HBME/HSBC@HSBC  
John F ROOT/HQHQ/HSBC@HSBC  
bcc:

From: David W J BAGLEY Tel: 7961 8645;44 2079 918645

Our Ref: Your Ref:

Subject: BUSINESS CASE - US PAYMENTS FROM IRANIAN BANKS/ENTITIES

Rick

I am of course aware of the efforts being made to find a compliant way of negotiating the OFAC sanctions and providing US dollar payment services to Iranian banks.

I have however received a copy of the business case dated January 2003 which has been referred to our colleagues in HBUS.

We clearly need to address this issue and attempt to find a compliant approach, and to that end I have asked one of my colleagues in HQHQ CMP, John Root, to assist with this process. He has already started looking at the OFAC sanctions from a Group perspective.

At this stage, however, I would be grateful if we could exercise greater care with regard to the content of written material being forwarded to our colleagues in HBUS.

The business case includes a number of express references to practices which may constitute a breach of US sanctions, including the OFAC provisions, and could provide the basis for action against the HSBC Group for breach of those sanctions, or seeking to facilitate a breach.

Could I suggest that future communications on this subject are perhaps cleared through John Root, or myself so as to avoid relative sensitive references.

I have asked John to discuss matters with HBUS and seek to take matters forward.

Regards

David

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From: Marion O ROACH  
 Sent: Tue Oct 21 17:10:24 2003  
 To: John F ROOT  
 Subject: IRAN - STRATEGY DISCUSSION PAPER  
 Importance: Normal  
 Attachments: image\_0.gif; image\_1.gif; image\_2.gif; image\_3.gif; image\_4.gif; image\_5.gif; Doc  
 Link.htm; Iran - Strategy Discussion Paper - Oct03.doc; OFAC Sanctions.doc

John

I refer to our discussions concerning the Iran strategy.

Attached is both the incoming, and my outgoing note relating to the various issues.

I would suggest that we do not take further action until there is some clarification as to the general direction we are expected to take.

Regards

David

Note  
 20 Oct 2003 15:28



From: Paul L Lee@HSBCAMERICAS Tel: 212-525-6533  
 Date: 10/21/03

Sent by: Nilda Venegas@HSBCAMERICAS

To: David W J BAGLEY

cc: David W J BAGLEY@HSBCAMERICAS  
 cc:  
 bcc:

Subject: IRAN- USD PAYMENTS

Permanent Subcommittee on Investigations  
**EXHIBIT #46**

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HSBC OCC 8873941

Note 15 Oct 2003 12:36

From: Youssef A Nasr  
 Title: President & CEO  
 WorkGroup: Chief Executive Office

Tel: 212-525-3580  
 Location: 452 5th Ave, Floor 19  
 FAX: 212-525-3580

To: Michael B Gallagher

To: Michael B Gallagher(HBUSHSBC@HSBCAMERICAS)

cc: Paul L Lee

cc: Paul L Lee(HBUSHSBC@HSBCAMERICAS)  
 Subject: Re: IRAN- USD PAYMENTS

Michael,

My main comment to David was, as stated in the text, that there remain serious political and reputational risks within the USA if they proceed with this and that he should ensure that Paul Lee is kept in the loop at all times because of the prior work he has done both on this and some recent approaches from Group offices about opportunities in Libya.

Youssef

Michael B Gallagher on 14 Oct 2003 10:28

Note 14 Oct 2003 10:28

From: Michael B Gallagher  
 Title: Executive Vice President  
 WorkGroup: Global Policy and Cash Mgmt

Tel: 212-525-5540  
 Location: 452 5th Ave, Floor 5  
 FAX: 212-525-5540

To: Youssef A Nasr

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HSBC OCC 8873942

To: Youssef A Nasr/HBUS/HSBC@HSBCAMER-CAS  
 Subject: IRAN- USD PAYMENTS

Youssef,

The below note suggests that that you have had recent discussions on this topic. Appreciate any guidance you may have on how you wish us to proceed.

Regards,

Michael

----- Forwarded by Michael B Gallagher/HBUS/HSBC on 10/14/2003 10:26 AM -----

Memo 14 Oct 2003 10:07

From: Ajay BHANDoola @ HSBC  
 Title:  
 WorkGroup:

Tel:  
 Location:  
 Start Date:

To: Michael B Gallagher

To: Michael B Gallagher/HBUS/HSBC@HSBCAMER-CAS

cc: Gary BOON, et al

cc: Gary BOON/MGR PCM MEM/HBME/HSBC@HSBC  
 Nigel J WEIR/M18 MEM/HBME/HSBC@HSBC  
 Subject: IRAN- USD PAYMENTS

Michael,

Trust you are well. We had discussed Iran a while ago and since then there has been a lot of work that Denise Riley from your team and Gary Boon from the Middle East have done on Iran payments. With the improved situation in the Middle East (post the Iraq war, David Houghton (HBME Deputy Chairman) is keen on exploring possible business opportunities and has discussed this paper with Youssef Nasr at a recent offsite.

Steve Banner (HBME Planning) has suggested a possible way forward, however I had wanted to discuss this with you for your inputs. Let me know when you are available for a quick 10 minute call.

Regards

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HSBC OCC 8873943

Ajay

----- Forwarded by Ajay BHANDoola on 10/14/2003 -----

08Oct2003

Memo



To: Ajay BHANDoola/RM PCM MEM/HBME/HSBC et al

To: Ajay BHANDoola/RM PCM MEM/HBME/HSBC  
 Gary DOON/MGR PCM MEM/HBME/HSBC  
 cc: David H HODGKINSON/DCH MEM/HBME/HSBC  
 John BLANTHORN/END CIB MEM/HBME/HSBC  
 Paul L LEWIS/HBUS/HSBC/HSBCAMERICAS  
 Carolyn M WOOD/HBUS/HSBC/HSBCAMERICAS  
 Warren G LEAMING/R/LA LGA MEM/HBME/HSBC  
 Nasser HOVAPOUR/HSBU/HSBCAPAC/HSBC  
 Nigel J WEIR/RM IS MEM/HBME/HSBC/HSBC  
 bcc:

From: Steve BANNER Tel: 971 4 3908200

Our Ref: Your Ref:

Subject: IRAN - USD PAYMENTS

Ajay / Gary,

As discussed, I attach a copy of the draft discussion paper on Iran.

David Hodgkinson discussed this paper, and the general topic of Iran, with various members of the top team during the recent offsite in London. Notably, he held discussions with Youssef Nasr covering, amongst other things, the topic of USD payments.

David advised yesterday that he is keen for HBME, together with HBUS, to explore in more detail the alternative ways in which we might be able to offer USD payment services to Iranian banks. Youssef Nasr has suggested that our first point of contact in HBUS should be Paul Lee, their legal advisor.

I had a brief telephone conversation with Paul this afternoon during which we agreed that the best way to take this forward would be to have the relevant PCM specialists within each organisation work together on the preparation of a feasibility study that examines the alternative options and the risks associated with each.

Paul has recommended that you work closely with external legal counsel in Washington to ensure that the various legal and compliance implications of each option are properly considered. Paul has suggested

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that you make contact with Carolyn Wind, HBUS' Head of Compliance, who will be able to put you in contact with their recommended external counsel.

I would greatly appreciate it if you could progress this with a view to having a draft of the feasibility study available for review by HBME/HBUS senior management by 21 November.

Thanks and regards

Steve

----- Forwarded by Steve BANNER on 10/08/2003 -----

02Oct2003

Memo



To: Iain F EDWARD/HQHQ/HSBC@HSBC et al

To: Iain F EDWARD/HQHQ/HSBC@HSBC  
cc: David M HODGKINSON/DCH MEM/HBME/HSBC@HSBC  
Tim W O'BRIEN/GGM PI G GHQ/HQHQ/HSBC@HSBC  
bcc:

From: Steve BANNER Tel: 971 4 3606290

Our Ref: Your Ref:

Subject: FOLLOWING NOTE SENT FOR DAVID HODGKINSON

Iain,

As discussed, I would greatly appreciate it if you could pass the attached discussion paper to David Hodgkinson.

Many thanks and regards

Steve



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HSBC OCC 8873945



Memo

21 Oct 2004 11:08

From: David W J BAGLEY/HQ/HSC

Tel: 7861 8645

44 2379 818645

(313) 856 4113

Sent by: Martin O'ROACH

Steve BANNER et al

To: Steve BANNER/MGR PLG MEM/HME/HSC@HSC  
 cc: Tim W O'BRIEN/MGR PLG HQ/HQ/HSC@HSC  
 David H HODGKINS/VOCH MEWH/BME/HSC@HSC  
 John F NOOT/HQ/HSC@HSC  
 bcc:

Subject: IRAN - STRATEGY DISCUSSION PAPER

Following the discussions initiated by Ajay Bhattacharya with Paul Lee which I know happened at Youssef Nasr's suggestion, Paul Lee made contact with me expressing some concerns.



Having considered the strategy discussion paper, there seemed to me to be a number of issues which require clarification, particularly in relation to OFAC.

In no particular order these are as follows:-

I am not sure that the interpretation of the U-turn exemption relating to the Iran sanctions is accurate. A detailed consideration of the OFAC sanction in question makes it clear that the minor and beneficiary of a U-turn qualifying payment must be both non-US and non-Iranian. I attach a summary note prepared by John Root (who happens to be a US lawyer) which I hope is of some assistance, although it is a general note relating to all OFAC sanctions not just those relating to Iran. The position is not helped however by what appears to be contradictory advice on OFAC's own website where in one example Bank Mellat is described as being capable of benefiting from a U-turn exemption, but in another example is excluded by reason of the fact that it is a government owned Iranian bank. We will seek to clarify this apparent discrepancy.

I am of course aware from my past, of the existence of a number of USD denominated facilities issued in

Redacted Material

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HSBC OCC 8873946

relation to Iran. What concerns me is the extent to which such facilities, if they remain in USD, are viable once there is a requirement to disclose details of the remitter of settling payments. Would this not make settlement under these facilities somewhat complex.

I am not sure that HBUS are aware of the fact that HBEU are already providing clearing facilities for four Iranian banks, presumably including USD clearance. Bank Mofattazi is named in the OFAC sanctions as a government owned bank and thus on the face of it not able to benefit from U-turn exemptions. I think we should give consideration to the current PCM services and the identity of the banks to whom those services are currently provided in the context of considering our overall risk appetite.

When we considered the Bank Melli clearing proposition my understanding was that we would consider either enhanced screening of payments for the U-turn exemption within HBUS (with presumably that extra cost being supported by HBUS) or alternatively looking to pre-screen payments for U-turn compliance within HBEU. Is this contemplated by the proposed expansion of activity in relation to PCM?

I am not sure that the current political position with regard to the US has changed in any significant manner from the point at which we determined that Project Deluga, and the Bank Melli clearing proposition were inappropriate.

As I would be reluctant to undertake significant work, particularly in relation to the incurring of US Attorneys' fees, before it was clear that this was worthwhile, I would be grateful for an indication from you or those copied as to whether further work would be appropriate at this stage.

Regards

David





## IRAN - STRATEGY DISCUSSION PAPER

PRIVATE AND CONFIDENTIAL

## Purpose

This paper has been prepared to seek GHQ's "in-principle" agreement, and HBUS' "no objection", to:

- the adoption of a more aggressive approach to the pursuit of Iranian business opportunities, and
- an acceleration of the Group's strategy of "gradual engagement" with Iran.

## Brief Country Overview

The Iranian market offers substantial untapped potential for the HSBC Group. That said, there are socio-demographic and political challenges that need to be considered when determining strategy. To briefly summarise some of the country-specific highlights:

## Economy

- With a GDP of c. 110bn in 2002 Iran is the 2nd largest economy (after Saudi Arabia) in the Middle East and North Africa region. The country experienced an average 5.8% growth in GDP over the past three years, and GDP is forecast to reach 9% next year. This growth has been largely driven by government policy changes (some of which are described below). The strong performance of the oil and agricultural sectors have also contributed.
- Iran's economy is heavily reliant on oil. The country has proven reserves of c. 90bn barrels, the 3<sup>rd</sup> largest in the world (after Saudi Arabia and Iraq), accounting for 8.5% of the global total. The development of Iran's oil industry has, however, suffered as a consequence of the US sanctions. Iranian oil production has remained relatively stable for the past decade, whilst global oil production has shown steady, albeit small, year-on-year growth (c. 14% up since 1993). Whilst the oil sector's share of Iranian GDP has declined from 30-40% in the 1970s to less than 20% today, oil revenue still accounts for c. 80% of the country's export earnings and anywhere between 40-70% of government revenue, depending on the prevailing oil price.
- Iran has an estimated 26.6tr cubic metres of natural gas, the second largest proven reserves in the world (after Russia), accounting for c. 15% of the global total. Iran is far behind some other Middle East countries (e.g. Qatar and Oman) in the development of its export capabilities. The Iranian government has recognised the potential for significant growth in this area and has set an ambitious target of doubling production by 2005.
- According to the Economist Intelligence Unit, Iran has only USD7.8bn of external debt, a relatively small proportion of annual GDP (c. 7%). The country has, in recent years, enjoyed a positive trade balance and had, at September 2002, approximately USD21bn of foreign currency reserves (approx. 10 months import cover).
- Although Iran's economic development has been strong in recent years it could, arguably, be much stronger. The recent reforms (discussed briefly below) have had a positive effect but these have proceeded at a relatively slow pace. The country's growth is still significantly hindered by the ongoing US economic sanctions as well as an archaic domestic banking system dominated by bureaucratic and inefficient government owned banks. Should the sanctions ever be lifted, and the liberalisation initiatives accelerated, the economic growth potential (and opportunities for strategically well-positioned banks) would be enormous.

## Socio-Demographic

- Iran's population of c. 65m is the second largest in the MENA region (after Egypt). On a per capita basis, the country's GDP is a relatively low USD1,700.
- Iran has a strong education system. The country has a c. 85% literacy rate (97% amongst those under 25).
- However, like several other countries in the region, Iran faces a significant demographic challenge with c. 50% of the population under 20 years of age.
- The Iranian government has been making a concerted effort to create jobs, with some success in 2002. That said, the unemployment rate remains high (estimated at 15% in 2003) and with 700,000 educated youths entering the labour market each year, there are inevitable social tensions (see Political comment below).

## Political

- Iran's 1979 constitution laid the foundation for an Islamic theocracy, with a supreme religious leader acting as the country's most powerful political figure, presiding over a legal system based on Sharia law. Following

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EXHIBIT #47

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## IRAN - STRATEGY DISCUSSION PAPER

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Khomeini's death in 1989 the constitution was amended and some of the supreme religious leader's executive powers were transferred to the elected president. As a result the country now has an, at times, "uncomfortable" dual power structure in which decision making authority is shared between (amongst others) the supreme religious leader and an elected president.

- \* There has been significant media coverage, in recent years, of the ongoing internal conflicts within Iran between the so-called "conservatives" (notably the Guardian Council, a legislative watchdog run by conservative clerics) and the "reformists" (led by President Khatami). Although Khatami's government has a clear mandate from the populace (he was re-elected with 78% of the vote in June 2001), the Guardian Council have succeeded in blocking a number of social, political and economic reforms that had been approved by the parliament. The Expediency Council (another government body headed by former President Akbar Rafsanjani) has, however, helped mediate some of the disputes, enabling the introduction of various reforms. For example:

- a new Foreign Direct Investment Law;
- abolition of foreign exchange control;
- the unification of the exchange rate;
- tax & tariff reforms;
- the creation of an oil stabilisation fund;
- laws allowing the establishment of private banks.

These reforms have helped create a more positive environment for foreign investment and have facilitated, amongst other things, Iran's successful entrance into the international capital markets with 2 Eurobond issues.

That notwithstanding, the pace of change is, for many, not fast enough and the country's demographic pressures and unemployment problems (60% of those that are unemployed are between 16-24) provide for potential unrest. The frustration amongst some student groups boiled over into street demonstrations earlier this year. These were quelled easily enough but most international commentators continue to believe that domestic tensions will remain for the foreseeable future, slowing the pace of reform and economic development.

- \* In 2001, the US renewed sanctions on Iran for 5 years under the Iran Libya Sanctions Act (ILSA). They also succeeded in blocking Iran's accession to the World Trade Organization (WTO). Tensions escalated last year when President Bush designated Iran as one of the principal countries supporting international terrorism. Relations between Iran and the US (and certain other countries) have further deteriorated in the past 12 months. A few notable examples of recent problems include:

- 1) The withdrawal of Moody's B2 rating on Iran - following a US Treasury investigation into whether the rating agency may have violated US sanctions against the country - further soured relations.
- 2) The US has repeatedly accused Iran of harboring terrorists and destabilising reform efforts in Iraq.
- 3) The death of a Canadian journalist, in Iranian police custody, has undermined Iran's relations with Canada.
- 4) The UK and Iran have had a diplomatic spat over the detainment (for potential extradition) of an Iranian diplomat who was studying in the UK. The British embassy in Tehran was subsequently shot at in what may (or may not) have been a related event.
- 5) Iran's nuclear policy (notably its unwillingness to sign additional protocols to allow enhanced inspections of its nuclear facilities) has put the country at loggerheads with, not only the US, but also some of the countries that are more favourably disposed to Iran politically (e.g. various European countries and Russia).

THR believe "Past experience shows that Iran will eventually find a pragmatic solution to stabilize the situation". It is worth noting that French and German companies / banks have been able to gain considerable credibility and business in Iran through their adoption of a pragmatic approach to the international political tensions.

## HSBC's Association with Iran

**Long History in Iran.** HME was founded under a British Royal Charter as the Imperial Bank of Persia in 1889. The Bank's first Chief Manager moved to Tehran that year and, by 1893, the Bank had opened branches in each of Persia's eight largest cities. By the Second World War the Bank had 14 branches across what was, by then, Iran. After the war, the Bank adopted an expansionary policy across the Middle East, establishing branches in Dubai, Muscat, Lebanon, Syria, Jordan and Saudi Arabia between 1946 and 1950. The 60-year banking concession

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expired in 1949, following which the various Iranian branches were gradually closed. The Tehran main office was the last to close in July 1952, at which time the Bank was re-named BBME.

BBME re-entered the country through a joint venture (Bank of Iran and the Middle East) in 1959. This bank was, however, nationalised in 1979 following the Islamic revolution.

**Initial Re-engagement.** HSBC re-entered Iran in 1999, establishing an HBME representative office in Tehran (THR). This office has, during the past four years, focused on a) raising the profile of the HSBC Group in Iran and b) actively supporting various Group members in their pursuit of business opportunities in Iran. The representative office has been very successful on both counts, with significant business wins in the areas of Project and Export Finance, Trade Finance and Treasury & Capital Markets. THR estimate that Iranian business generates c. USD7m p.a. in revenues for various Group entities.

The articulated strategy of the representative office has been one of "gradual engagement". The objective has been to systematically develop the Group's presence, capabilities and business flows in Iran in a steady and measured manner. Whilst business volumes, and the range of services offered, have continued to grow in the last two years the pace of "gradual engagement" has remained somewhat cautious. As a consequence, strategic initiatives such as "Project Beluga" (briefly described below) have, for a variety of justifiable reasons, been put on hold.

**Project "Beluga".** This initiative proposed the establishment of an offshore bank, modelled on First Direct, that would offer a range of banking services to customers on the Iranian mainland through remote distribution channels (further details are provided in Appendix A). Given legal restrictions, which inhibit foreign banks from establishing onshore banking operations in Iran, Beluga was seen as the most logical way to progress the strategy of "gradual engagement". The most recent iteration of this initiative (in 2002) did not progress very far as GHQ indicated that, whilst strategically sound, the timing of was not right (Iran was then, as now, facing strains in its relationship with the US government and the Group was, at the time, actively pursuing acquisition opportunities in the US).

**The Next Stage?** Iran clearly represents one of the most significant potential growth markets for HBME in the short, medium and long term (a brief synopsis of the potential business opportunities is outlined below). HBME believes that there is a need to:

- Adopt a more proactive / aggressive approach to the pursuit of new business in Iran; and
- More clearly define the next stage of its process of gradual engagement.

Guidance is required from GHQ (and HBUS) on whether they would have any concerns with HBME's proposals to accelerate business dealings with Iran.

**Business Opportunities**

HBME believe that the strategy should now be progressed in two phases:

- 1) **Phase 1.** The Group should seek an immediate increase in the quantum of cross-border business undertaken with Iranian counter-parties. Such will generate incremental business revenues whilst demonstrating, to both the Iranian authorities and our customers, the Group's continued commitment to developing its business / presence in this strategically important market.
- 2) **Phase 2.** In the medium term, there is a need for a more tangible presence in the country. If legislation were in place to allow us to establish an on-the-ground presence, the preferred route would be the establishment of an HBME branch or wholly owned HBME subsidiary in Tehran. In the absence of such legislation, a "revitalisation" of Project Beluga, in some form, may be a viable option.

Further details are provided below:

**Phase 1 – Immediate Opportunities**

We perceive there to be immediate opportunities to undertake significantly more profitable and creditworthy business in a variety of different business areas. Specifically:

1. **Trade Finance.** The Group has, at present, a USD120m short-term (<365 days) trade cap for Iran, with a forbidding sub-limit of USD10m. The utilization of this limit is very high (consistently > 85%) and, based on market feedback, our limits are substantially below those of our competitors (Standard Chartered, for example,

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- reportedly have a USD500m limit). HBME believe there to be immediate opportunities for further profitable business if the HSBC credit limit were significantly increased and the maximum tenor extended up to 3 years.
2. **Project and Export Credit Finance.** HBEU provides a multi-source ECA covered Medium-Term Export Credit line of USD1bn to six Iranian banks. The Group have established a strong working relationship with [REDACTED] and HPEF have, as a consequence, worked on a large number of export credit transactions. The competition for business with [REDACTED], however, increasingly fierce and there is a danger that the Group will lose its competitive edge unless it is able to support / supplement the ECA backed facilities with a degree of commercial lending. Several European (notably French and German) banks have medium term commercial lending limits (BNP's limit is said to be USD500m) and they are becoming increasingly successful in pursuing business. THR and HPEF strongly believe that an ability to take medium term commercial risk in Iran will help the Group to retain a strong position in pursuing [REDACTED]. Moreover, the availability of such country risk limits will open the door for the Group's participation in a variety of [REDACTED] backed initiatives relating to oil and gas, power, steel, telecommunication and transportation projects.
  3. **Islamic and Corporate Bonds.** The government in Iran are considering issuing an Islamic Government Bond (Sakak) and various substantial Iranian corporate bodies have expressed an interest in undertaking Islamic or conventional corporate bond issues. HSBC Amanah has already secured a working mandate from [REDACTED] to study the possibility of issuing a corporate Islamic bond and, should this lead to a specific issuance, there will be related ancillary business opportunities. If the Group is to have any chance of winning such business it will need a medium term credit limit for Iran.
  4. **Advisory Services.** There is a growing demand in Iran, from both private and public sector bodies, for corporate finance advisory services. HSBC will pursue such business opportunities irrespective of whether there is an increase in credit risk limits. The likelihood of success would, however, be enhanced if HSBC's continued commitment to develop its Iranian business can be clearly demonstrated to "Iran Inc".
  5. **Financial Institutions.** THR has been able to nurture profitable business relationships with a variety of Iranian banks. Associated income is derived from trade services, project finance, treasury / money market operations and correspondent banking. The Iranian banking system is, effectively, controlled by the Iranian government. THR believe that our relatively small appetite to bank set and not-Iranian risk undermines the Group's position in the eyes of the Iranian authorities. This could undermine our chances of retaining the current volumes of business from Iranian banks.
  6. **Payments & Cash Management.** Iran undertakes approximately USD25bn of international trade annually, c. 80% of which is denominated in USD.  
HBEU PCM currently offer USD payment services to 4 Iranian banks. There is an opportunity to actively market our PCM capabilities to other Iranian commercial banks, including Iran's Central Bank (Bank Markazi). HBME PCM believe that the potential business to be won would be worth up to USD4m pa.  
The US sanctions and the impending UK legislation resulting from the FATF recommendations, however, significantly complicate the USD payments process for Iranian counter-parties. HBME PCM has identified a practical solution that requires additional support from both HBEU and HBUS. As explained under "Issues for Consideration" below, there are still some reservations about undertaking more of this type of business.

To support HBME's desire to more aggressively pursue Iranian business opportunities, and to provide a foundation for the ongoing evolution of our strategy of "gradual engagement", HBME will shortly prepare a paper for GHQ CRF's consideration requesting appropriate increases in relevant country risk limits for Iran.

The identified PCM opportunities have, if pursued, several potential implications (examined under "Issues for Consideration" below). As such, HBME require the "in principle" support of GHQ (and HBUS) before actively marketing our PCM capabilities in Iran.

**Phase 2 – Medium Term Strategy**

The request for an increase in credit limits will, if approved, enable the Group to generate increased income from Iran in a variety of business areas. In the medium to long term, however, we need a strategy that provides the Group with the ability to provide a wider range of corporate banking services, domestic personal financial services

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(probably a limited offering for high end customers) and various Islamic banking services. (The domestic banking market in Iran is entirely Shariah compliant. There are potential opportunities for HSBC Amanah Finance to develop products for sale / distribution through either an HSBC owned / managed entity or through local banks).

HBME's preferred strategy, when the legislation and market conditions in Iran allow, would be to establish an onshore branch (or, if the law required, a locally incorporated wholly owned subsidiary).

In the absence of any such legislation a "Project Beluga" type structure offers an alternative vehicle through which the process of "gradual engagement" can be progressed. (The establishment of a remote banking operation would not prevent the Group from potentially establishing an onshore branch at a future date).

The business case for the establishment of a Project Beluga type vehicle is not as robust/compelling as would be the case for an onshore branch. That said, HBME believe that the Beluga option is still worthy of consideration in the medium term as a method of ensuring that HBME remain one of the dominant international banks in Iran. (Standard Chartered have already assumed "first mover" status by announcing their intention to establish a branch in Kish Island). Whilst HBME are not advocating any immediate action in this regard they would like to keep their options open to pursue such an initiative in one or two year's time, subject to market developments.

HBME request guidance from GHQ and HBUS on the potential implications for the Group of pursuing such an initiative sooner rather than later, both in terms of reputation and our US business interests.

## Issues for Consideration

In assessing HBME's recommendation, GHQ will (in consultation with HBUS), need to consider a number of specific issues:

## 1) Domestic Political Situation

One of the reasons to accelerate our process of engagement is to demonstrate, to the authorities within Iran, that we are committed to the development of their country. This is seen to be particularly important given the more aggressive / pragmatic approach to Iranian business adopted by French and German competitor banks.

Such a demonstration should, theoretically, enable HBME to develop a stronger market position in what remains, for the time being, a state-controlled economy. That said, the internal conflicts within Iran's political structure are significant and not all parties within Iran will welcome increased involvement of foreign owned banks in Iran. We consider there to be two potential scenarios with respect to the domestic political situation:

- a) **Significant Upheaval.** In extreme circumstances (which HBME consider to be highly unlikely) it is possible that the ongoing internal political conflict will escalate, leading to further social unrest and, ultimately, enforced regime change. If such a scenario were considered likely it would, of course, seriously dampen the Group's appetite for Iranian credit risk and would necessitate a deferral of any Project Beluga-type initiative. (Such a scenario need not, necessarily, discourage the immediate pursuit of PCM business).
- b) **Gradual Process of Reform.** HBME believe that it is far more realistic to assume that there will be a gradual process of economic and social reform with, admittedly, inevitable internal conflicts along the way. Whilst this latter scenario will result in sub-optimal economic growth, it does suggest that the economic situation will continue to improve over time and, as such, an increase in credit limits and provision of PCM services is entirely appropriate. The bureaucracy that might be created by any internal conflict could act as a deterrent to the pursuit of a "Phase 2" initiative in the short term. That said, if there is a belief that Iran will, over time, become an increasingly attractive market, then a compelling case can be made for increasing our profile sooner rather than later, notwithstanding the logistical challenges.

2. **US Regulations.** There are two principal areas of US law that would affect any attempt to a) provide USD PCM services to Iranian counter-parties and b) establish a more tangible presence in Iran. (These regulations are unlikely to directly impact the various initiatives that are reliant on the provision of increased credit limits):

- 1) **US Office of Foreign Assets Control (OFAC) regulations,** which prohibit US transactions with Iranian entities. HBME has received legal advice in 2000, 2001 and 2002 on the OFAC regulations.
  - **Implications for the provision of PCM services.** The sanctions against Iran prohibit US banks from

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providing correspondent banking services for Iranian banks. The OFAC regulations do, however, allow a mechanism (the "U-Turn exception") whereby USD payments can be settled on behalf of Iranian counter-parties, through a US settlement bank, provided that neither the originating or beneficiary bank are US institutions. In practice, the U-Turn mechanism currently works as follows in HSBC:

- a) An Iranian bank opens a USD account with HBEU,
- b) HBEU receive USD payment instructions from an Iranian bank in favour of a beneficiary account held at a non-US bank. HBEU instructs the beneficiary bank and arranges for settlement through its own USD account with HBUS;
- c) Provided there is no reference to the Iranian counter-party in the USD settlement instruction, the transaction would pass through HBUS seamlessly. If, however, the name of the Iranian counter-party is included in the settlement instruction, HBUS will be obligated to check whether the transaction qualifies for the OFAC U-Turn exception. If in doubt, HBUS will refer the transaction to OFAC. OFAC would then either approve or reject the transaction. In certain circumstances (e.g. the matter is a known terrorist), OFAC has the right to arrange for the funds to be frozen.

Until now HBEU have not been required to reveal the identity of the originating Iranian counter-party (UK legislation related to FATF regulations will henceforth require the identity of the ordering customer to be clearly communicated in all such payments. If, therefore, the Group decides to pro-actively promote USD payments services to Iranian banks the payments will need to be processed by HBUS with full details to satisfy OFAC requirements. There will, therefore, still be a need for additional resources in HBUS to identify, check and process such payments. Two concerns, in addition to the costs and logistical difficulties, have been raised:

- i) HBUS could be held liable (and staff within HBUS, personally liable) if mistakes are made
- ii) The increased volume of Iran related transactions would be noted by OFAC. In the current political environment it is conceivable that the US administration will think less highly of HSBC if it grows its business dealings with Iran (see below commentary on the international political situation).

We understand that the impending change in UK legislation has led Lloyds TSB to give notice that they will be withdrawing their existing payments service offered to Iranian banks.

- **Implications for the establishment of a more tangible presence in Iran**

- 2) *The USA Patriot Act*, passed in the aftermath of the various attacks on 11 September 2001, governs US correspondent banking arrangements for foreign banks generally.

Under the OFAC regulations no Iranian incorporated bank can have a bank account in the US. As such, the provisions of the Patriot Act apply *indirectly* to any Iranian bank that uses HBEU to process U-Turn payments. Patriot Act requirements would, in such circumstances, be imposed on HBEU by virtue of its maintaining a correspondent account at HBUS. HBEU would therefore have to satisfy itself that each of the relevant Iranian banks has a rigorous know-your-customer and anti-money laundering program.

Neither of the two applicable laws present an insurmountable barrier to either the relevant Phase 1 strategy (i.e. the provision of PCM services to Iranian banks, including Bank Markazi) or the potential Phase 2 strategy. That said, the laws do create a significant amount of additional workload and, in the case of the OFAC regulations, open the Group to additional potential risks. Other issues are raised by the need to liaise with the US authorities to secure compliance with these laws (see below).

### 3. International Political Situation

Iran has, as already explained, faced a variety of international political problems in recent years. The country's standing in the international community is, at time of writing, not strong and it looks extremely unlikely that the US sanctions against Iran will be lifted in the short to medium term. That said, the prospect of the US escalating its anti-Iran rhetoric and taking direct military action against the country can be considered to be highly remote. The international political tensions influence different elements of the strategy in different ways:

- **Credit Limits.** If the external political environment for Iran remains tense, it could complicate the domestic reform effort and, in turn, undermine the economic prospects for the country. That said, the country has a strong

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economy, despite the existence of sanctions. As long as we believe that there is little chance of either:

- a) the imposition of UN sanctions related to the nuclear conflict (highly unlikely) or
- b) a direct military conflict with Iran (extremely unlikely),

we need not let the rather delicate international political situation deter us from seeking increased credit limits / business flows from Iran. (The US government is unlikely to view the provision of USD750m of credit facilities dramatically different from the provision of USD100m or USD250m).

- **PCM Business.** The international political tensions are, however, of relevance when considering whether to offer USD payment arrangements to Iran's banking sector and, specifically, its Central Bank. Such arrangements would (as explained above) necessitate the use of US based banks for USD clearing. The US authorities would, given changes in the UK law, be aware of the Group's increased interaction with Iranian counter-parties. Given the delicate political climate, there is the potential for HBUS to lose the valuable goodwill of the US authorities if the Group is perceived to be co-operating with what the US perceive to be an unfriendly nation. From a Middle East perspective this is in the Group's commercial and strategic interests to provide greater PCM services to Iran's financial sector. GHQ, in consultation with HBUS, need to advise whether it is in the Group's strategic interests to do so.
- **Phase 2 strategies.** The most recent iteration of Project Beluga (informally proposed in IH02) did not proceed as, in the view of GHQ, the timing was not right given, inter alia, the ongoing tensions with the US. Iran's present international political position is, if anything, more tense than in mid-02. That said, the HSBC situation has evolved since that time as the Household acquisitions has been completed. This could, depending on one's perspective, justify an adoption of either a greater or lesser level of sensitivity to international / US political concerns vis a vis Iran.

## Summary &amp; Recommendation/Request

Iran is a resource rich country which is in the process of developing / liberalising its economy and finance sector. There will, in the short term, be attractive transactional opportunities for financial institutions that have the appropriate marketing resources and requisite credit appetite. In the long-term a compelling strategic case can therefore be made for the Group to strengthen its foothold in what will become an increasingly important market.

With this in mind, HBME wishes to accelerate the pace of its engagement with Iran. The extent of HBME's engagement has, in the recent past, been curtailed by either:

- a) lack of credit appetite (largely at GHQ level) or
- b) concerns regarding the political implications of a closer association with Iran.

This paper has been raised to seek GHQ's approval (and HBUS' "no objection") to a two-phased, three pronged strategy which sees the Group, in the short term:

- i) formally acknowledging an increased appetite for Iranian risk;
- ii) actively marketing PCM services to a larger number of Iranian financial institutions, including Iran's Central Bank,

and, in the medium to long term:

- iii) actively pursuing the opportunity to enhance our presence in Iran through either the establishment of an onshore branch/subsidiary or, if the law does not allow that, the pursuit of a Project Beluga type offshore banking solution.

Whilst recommending that the process of engagement is accelerated, HBME are mindful of the potential implications for other HSBC businesses and the HSBC name in general. As such, the guidance and views of both GHQ and HBUS are sought.

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## Appendix A – Background to Project Beluga

HIDME has, since, mid-2000, been considering "Project Beluga" (in various forms) as the logical next step in the process of "gradual engagement". The rationale behind this initiative, and a basic outline of the business model, follows:

*Background.* Foreign banks are not presently permitted to establish anything more than a representative office on the Iranian mainland. Various Central Bank officials have indicated that the market will "soon" open up to foreign banks but opinions differ on when exactly this might happen. Legislation introduced in 2000 does, however, allow foreign banks to incorporate a wholly owned "offshore bank" in one of Iran's three Free Trade Zones (FTZs). Such banks can offer services remotely to individuals and corporations on the Iranian mainland.

*Rationale.* In line with the strategy of "gradual engagement" HIDME have, in both H101 & H102, looked at the possibility of establishing an HSBC branded / managed remote distribution bank (modeled on First Direct) in Iran's Kish Island FTZ. Such was, at the time, seen to be the most logical way to progress our Iran strategy.

*Business Model.* The most recent iteration of this initiative involved a JV with two of Iran's largest banks (Bank Mellat and Bank Saderat). The business model envisaged the Kish incorporated JV providing a limited range of financial services to customers on the mainland through a combination of a) direct banking channels and b) JV representatives based in selected Mellat and Saderat branches. It envisaged a relatively simple product offering initially (i.e. deposits, payments) which would gradually evolve (i.e. credit cards, wealth management, trade facilities) over time. The primary objectives of the initiative were to:

- build the HSBC brand in the Iranian market,
- gain "first entry" status and position the Bank for future growth; and
- develop new revenue streams.

Negotiations with Mellat and Saderat did not progress very far in 2002 as GHQ indicated that, whilst strategically sound, the timing of such an initiative was not right.



From: John F ROOT  
 Sent: Thu Oct 23 11:07:41 2003  
 To: David W J BAGLEY; Susan A WRIGHT; John ALLISON  
 Cc: Paul PROCTOR; John F ROOT  
 Subject: USD Clearing - Iranian Banks  
 Importance: Normal

EPS HBEU have been manually intervening in the processing of Iranian bank payment instructions by removing the remitter's name and country to prevent the probable trigger of a filter in the US, and the subsequent declaration to OFAC (and possible freezing) of the funds.

EPS have apparently been instructed by Compliance to cease this practice. (It is somewhat unclear whether this instruction was in writing, or when it was given and by whom.) However, given "long-standing valuable relationships", ISL have purportedly negotiated a cut-off date of 31DEC03 for the current practice to stop. (Brian Richardson and John Wilkinson in essence deny that they were even aware of the practice, let alone that they have been pushing for an extension of it.)

After 31DEC03 complete payment instructions will be sent on to HBUS. EPS also intend to consider MT202 cover payments to be "unacceptable" after such date, and payment instructions will be fully formatted on a MT100/103 serial basis only. However, there has been some question as to whether the MT100/103 format is an actual legal requirement. So far this does not appear to be the case. A further wrinkle is FATF Special Recommendation 7, which calls for accurate and meaningful originator information. Individual countries are then expected to exempt FI-to-FI transfers.

There are approximately 11 payments every business day. USD clearing services are provided for the following banks:

Melli  
 Tejarat  
 Keshavarzi  
 Markazi  
 Export Development Bank  
 Sepah

All of the banks are on the OFAC list of state-owned banks, except for the Export Development Bank. As it is a reasonable assumption that the Export Development Bank is a state-owned bank, either its omission is an oversight by OFAC, or one of the other banks may in fact be the Export Development Bank. At any rate, it is prudent to assume that it is also a target of the OFAC sanctions.

Two banks - Tejarat and the Export Development Bank - account for around 90% of monthly payments (210 out of 233).

John Wilkinson, the HBEU RM, should notify the Iranian banks of the above payment instruction changes by letter at the end of October. Wilkinson is awaiting HBUS agreement before sending the letter. The Iranian banks will be given a disclaimer on the possibility of the application of OFAC sanctions. The disclaimer will state that the Iranian bank in question will remain responsible for complying with OFAC sanctions. The full effectiveness of such a disclaimer can be doubted, particularly as it is not market practice to have written agreements with correspondent banks.

Project Wolf, which should be effective at the end of November, will not necessarily screen for compliance

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with the "U-turn" payments exception, according to Paul Proctor. Wolf's focus will be to screen for, e.g., terrorists and drug traffickers against government-issued lists. HBUS will continue to be responsible for full screening with regard to OFAC sanctions, which have a broader application than the names screened by the Wolf system.

A related issue is the effectiveness of Iranian correspondent bank money-laundering control procedures for the purpose of USA Patriot Act certification.

The business state that they intend to keep payments "at a low level" but then add that higher payments will require a re-negotiation of fees. Also, there are plans under consideration to increase the USD clearing business with Iranian banks - provided that HBUS are in "full agreement".

John Root

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From: John F ROOT  
 Sent: Fri Oct 24 13:08:33 2003  
 To: David W J BAGLEY; Susan A WRIGHT; John ALLISON  
 Cc: John F ROOT  
 Subject: Iran  
 Importance: Normal  
 Attachments: image\_0.gif; image\_1.gif

Please see below the memo from Rod Moxley in Payment Services.

Regards,

John Root

----- Forwarded by John F. ROOT/HQHQHSBC on 24 Oct 2003 13:08 -----

Memo

24 Oct 2003 12:10



From: Paul PROCTOR/HQHQHSBC

Tel: 799 12778

44 20 7691 2778

Mail Size: 10000

To: John F ROOT

To: John F ROOT/HQHQHSBC@HSBC

cc:

bcc:

Subject: Iran

John,

Latest status info on this issue from Rod Moxley in Payments Services.

The practice of amending instructions is clearly a long standing one which has hitherto continued despite the RMs believing it had ceased some years ago; I have never seen anything in writing to show how/when this practice commenced or who authorised it but clearly the proposed termination will need to

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be handled with sensitivity if relationships with the Iranian banks are not to be damaged.

I am on leave next week. I am sure that John Wilkinson/Brian Richards (London RMs) would be happy to answer any further questions in my absence. At this time though, they are unaware from me of your high-level involvement.

Regards,

Paul,

----- Forwarded by Paul PROCTOR/HBEU/HSBC on 24 Oct 2003 12:08 -----

Memo  
24 Oct 2003 08:40



From: Rod MOKLEY/HBEU/HSBC

Tel: 790 44479  
44 20 7260 4479

HSBC 5.12.02 12:08

John R WILKINSON et al

To: John R WILKINSON/HBEU/HSBC@HSBC  
cc: Geoff ARMSTRONG/HBEU/HSBC@HSBC  
Quentin R AYLWARD/MDBK/HSBC@HSBC  
Brian W RICHARDS/MDBK/HSBC@HSBC  
Paul PROCTOR/HBEU/HSBC@HSBC  
Nasser HOMAIPOUR/HBBL/HSBCAPAC@HSBC  
Julie A CLARKE/HBEU/HSBC@HSBC  
Malcolm G EASTWOOD/MDBK/HSBC@HSBC  
Tony P COLLINS/HBEU/HSBC@HSBC  
Dan SALE/HBEU/HSBC@HSBC  
Simon R VICKERY/HBEU/HSBC@HSBC  
Gary BOON/MGR PCM MEM/HBME/HSBC@HSBC  
Martin S CLARK/HBEU/HSBC@HSBC  
bcc:

Subject: Iran

John,

Further to recent exchanges of emails, I detail below my responses to the queries raised, together with a synopsis of my concerns on this issue.

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HSBC OCC 8874661

## Responses

HBUS have not been advised of the new procedures- we have attempted to engage them in our proposals before but have been expressly forbidden from continuing dialogue with them. I have been given a further directive from Malcolm Eastwood, Senior Manager Payment Services in the last few days not to contravene these instructions from our colleagues in US.

The procedures have therefore not been agreed and any potential changes in volumes of traffic are unknown to them.

Iranian banks have not been provided with clear guidelines with regard to the new formatting requirements. Possible solutions have been put forward by HBEU Payment Services but I do not believe they have been communicated to the Iranian banks. We can suggest that payments on behalf of the Iranians for small amounts are sent to us on a test basis but this does not give us or them a guarantee that all payments will be effected without problem.

The implications regarding OFAC are purely what we have gleaned from the OFAC website and previous historical correspondence. We have had no direct contact with OFAC and, being a US government agency, I understand that this would prove fruitless. In short, I believe straight MT202s are acceptable to US banks, providing full disclosure of the U-turn payment is apparent, although MT202 cover payments in support of direct MT103s are not acceptable. Additionally, OFAC have stated that they retain the right to freeze payments at their own discretion.

## Concerns

U-turn payments- there have been a number of views expressed regarding the validity, or otherwise, of the U-turn payments submitted to us. As a UK bank, our own understanding of US legislation is limited and, whilst we might believe we know what constitutes a U-turn payment, it would seem extremely risky for us to start telling Iranian banks what will and what will not comply. Lengthy discussions, per se, may expose us to unnecessary risks.

It was my understanding that the original business case submitted by Rick Pudner, Head of CIB, Middle East in January 2003 was not signed off. Indeed, Marilyn Spearing has underlined the strong operational and reputational risks involved and further support to this view was given by Begley who suggested holding off due to the acquisition of Household. I would be grateful if you could confirm that the appetite for this business has been authorised at the appropriate level.

The position of Risk Management Services (RMS) is becoming increasingly untenable. RMS controls the Project Wolf filter and yet we have been requested to find ways to circumnavigate our own and other institutions' compliance filters. My own role is predominantly to protect the Bank from reputational risk and I now feel uncomfortable in compromising my position by leading IBL, PCM or Iranian counterparties down certain routes which may directly contravene the spirit of the Compliance framework. If this business is to be progressed or expanded (as indicated in Nigel Weir's note) the impetus for formatting solutions will need to come from PCM MEM. HBEU's role is to pay as instructed and with effect from 1 January 2004 this will be reinforced, as no Iranian payments will be amended.

Despite coherent arguments being put forward by a number of parties within HSBC, it is still worth noting that some US banks, notably Bank of New York, refuse to deal with U-turn payments due to the high risk nature of these transactions and the potential for possible fines, censure or reputational risk. I have copied Group Compliance in on this note to ensure they are aware of and do not have a problem with this continuing risk to HSBC.

I have been alarmed by recent inferences that Payment Services have been amending the Iranian banks' payments without the knowledge or consent of IBL RM or IBL Compliance. This has been a long standing practice and to avoid future doubt, I will reiterate the points made in Malcolm Eastwood's memo to Nigel Weir of 22 Jan 03. If we are to continue to effect those payments, we will require your commitment that Iranian customers will be provided with a template and it is made clear at the proposal stage that:

-payments must be submitted in this format only.

-that payments submitted in the wrong format which may be sequestered by OFAC are entirely at the Iranian remitter's risk, albeit we will submit the appropriate OFAC request forms licences to retrieve funds when sanctions are lifted.

-that we will not be liable for any funds sequestered as a result of changes in Iranian Sanctions by the US authorities which might lead to a payment "correctly" formatted being sequestered.

I am uncertain as to the extent to which the Iranian banks are aware of the differing views and procedures adopted by individual US banks which complicates this issue, but it is imperative that they are aware of our stance from 1 January 2004.

I think you now have all the information which is available at this stage but please let me have your views when you have had a chance to digest and discuss with your customers.

Regards

Rod

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HSBC OCC 8874663

From: DENISE A REILLY/HBUS/HSBC  
 Sent: 12/17/2003 9:40:38 AM  
 To: TERESA PESCE/HBUS/HSBC@HSBC  
 CC:  
 Subject: COMPLIANCE - OFAC ISSUES IN GENERAL AND SPECIFIC TO IRAN

Attached is the memo that we discussed yesterday in our meeting with Michael Gallagher.

----- Forwarded by Denise A Reilly/HBUS/HSBC on 12/17/2003  
 09:40 AM -----  
 Denise A Reilly on 14 Nov 2002 15:02  
 Note  
 14 Nov 2002 15:02

From: Denise A Reilly Tel: 302.636.2500 Del  
 Title: Senior Vice President Location: Delaware  
 WorkGroup: Payment Services Mail Size: 45451

To: Carolyn M Wind/HBUS/HSBC@HSBCAMERICAS  
 cc: Michael B Gallagher/HBUS/HSBC@HSBCAMERICAS  
 Subject: COMPLIANCE - OFAC ISSUES IN GENERAL AND SPECIFIC TO IRAN

We need to discuss.

----- Forwarded by Denise A Reilly/HBUS/HSBC on 11/14/2002  
 03:03 PM -----  
 Valerie ROLLE @ HSBC on 14 Nov 2002 12:56  
 Memo  
 14 Nov 2002 12:56

From: Valerie ROLLE @ HSBC Tel: 7904 5557  
 44 2072 60557  
 Title: Location:  
 WorkGroup: Mail Size: 41980

To: Denise A Reilly/HBUS/HSBC@HSBCAMERICAS  
 Geoff ARMSTRONG/HBUS/HSBC@HSBC

cc: Pat N CONROY/HBUS/HSBC@HSBC  
 Marilyn H SPEARINGHD PCMHBUS/HSBC@HSBC  
 Quentin R AYUWARDINDG/HSBC@HSBC  
 Rod MOXLEY/HBUS/HSBC@HSBC  
 Paul PROCTOR/HBUS/HSBC@HSBC  
 Steve WEBSTER/HBUS/HSBC@HSBC  
 Nigel J WEIRW IS MEM/HBUS/HSBC@HSBC  
 John R CHAPPENDEN/HBUS/HSBC@HSBC  
 Subject: COMPLIANCE - OFAC ISSUES IN GENERAL AND SPECIFIC TO IRAN

Denise/Geoff,  
 For your information.

Permanent Subcommittee on Investigations

EXHIBIT #50a

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 Confidential - FOIA Treatment Reques

s, Inc. HSB03793159  
 HSBC OCC 3407517

808

Regards,

Malcolm

Attachment: COMPLIANCE - OFAC ISSUES IN GENERAL AND SPECIFIC TO IRAN.doc.zip

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HSBC Bank plc

Memo

To Denise Reilly Geoff Armstrong		Date 14 November 2002
From Malcolm Eastwood		Sender's Reference
CC Pat Conroy Marilyn Spearing Quentin Aylward Rod Moxley Paul Proctor Steve Webster Nigel Weir John Chappenden		
Subject <b>COMPLIANCE – OFAC ISSUES IN GENERAL AND SPECIFIC TO IRAN</b>		Receiver's Reference
To Facsimile No.	From Facsimile No. 020 7260 9796	Total No. of pages

This note forms a discussion paper formulated following various conversations that have taken place over the last few weeks. As the custodian of HBEUs payments operation I currently feel that we may be exposing ourselves to unnecessary and unacceptable Reputational and Operational Risk when we are handling payments originating from FIs domiciled in or who are a local branch of an FI domiciled in an OFAC regulated country. As a result there is a need to firstly clarify both the OFAC and HBUS position with regard to these payments and then to determine/communicate the way forward to the RM and PCM Sales teams.

I would emphasise that in no way we are seeking to avoid the OFAC filtering/sequestration arrangements here. Indeed whilst HBEU are not bound by these requirements the FATF principles which are scheduled to become legislation early next year and our own payments filter which is currently being built will take us closer to the US model. I merely wish to establish which way OFAC are looking to deal with the sequestration issue so that we can plan compliance and avoid substantial potential losses which can result from the "incorrect" processing of these payments.

#### BACKGROUND CASES

The above comments are prompted by two high profile OFAC related cases seen in the last few months.

The first is a case involved Ing Bank sending a payment for USD 3M to BBVA from and to the account of the same Cuban Bank beneficiary. HBEU forwarded this payment to HBUS via the Serial Payment route. The HBUS filter identified the Cuban bene and the funds were sequestrated by OFAC. The result of all this is that we are in the closing stages of correspondence between HBEU and Ing lawyers pending a Court case between our two banks. Ing are contending that HBEU should not have sent this payment via a Serial method and that we should have converted the message to generate a cover payment which would not have then been sequestrated by OFAC. We are defending our action vigorously and have a strong case built around the fact that we "paid as instructed". Prudence dictates

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that we have found it necessary to raise a general provision of GBP 2M to cover a potential negative result if and when this goes to Court.

Continued

2

#### **Compliance -- OFAC Issues In General And Specific To Iran**

The second case involves Iran and Bank Markazi when a payment for USD 7.5M was frozen again because the payment was sent via a Serial Route and the OFAC filter identified it as being subject to OFAC rules. Following assertions by HBEU that there was no commercial transaction involved (this was the Iranian Central Bank paying itself at another European bank ie a Money Market transaction) these funds were released but only after a couple of sleepless nights for all of us in London. I have subsequently been advised that this sequestration may have been the result of a clerical error by HBUS but this has not been confirmed to me. Nevertheless HBEU are left settling Standard Chartered's interest claim for late receipt and with an underlying feeling of uncertainty with regard to the Iranian payment issue and the subject of U Turn Payments (we believe that the above payment should have been treated as U Turn) and had thought that this practice was established in the US as a valid payment method specific to Iran.

#### **COMPLIANCE WITH OFAC ISSUES GENERALLY**

HBEU's historical practice has been to send these types of payments where the U Turn principal applies (ie funds are generally moving from an European bank to another European bank for the credit of an OFAC regulated entity) via the Cover Payment method. This means that the payment instruction received by HBUS contains no mention of the country or entity involved. My understanding is that this has been accepted practice for many years and that HBEU IBL hold accounts, some in USD for FIs domiciled in these countries ie Cuban, Iranian etc.

There is also evidence (the Ing Bank case being a case in point) that some other European FIs are using HBEU to transact business with these banks, primarily because the benes hold accounts with HBEU but also because they use us as a form of "Filter" for payments being made to the US. Whether we should be supporting this latter business going forward is highly questionable particularly in the light of the FATF regulations. Indeed Ing Bank will be asked to close their account shortly. I feel that there is a need for HBEU IBL to examine the accounts of these OFAC regulated customers to see if there are other examples of other banks with accounts in our books using us for this purpose.

My understanding is that OFAC's tolerance of the Cover Payment method is lessening and that there is some pressure being applied to follow the Serial Payment route for all transactions (Denise can you confirm?). Clearly if this is reality this will have major implications for HBEU both from a payments processing and IBL relationship stand point. We therefore need to seek clarification of HBUS/OFAC's stance so that we can determine our future payments strategy. Certainly the FATF requirements, whilst not specifying Serial instead of Cover do point toward the principle of "transparency" which the Serial Payment method would support.

Continued

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IRANIAN PAYMENTS

Turning specifically to Iran we have seen the various papers on the subject of U Turn Payments and I believe that we have a reasonable understanding of what these are. The above Markazi situation has put uncertainty in my mind on the validity of this payment method and also highlighted the fact that HBUS have yet to formally “sign off” the process described in your last note. Our conversation suggests that HBUS are now looking at another “U Turn plus” option and I would like to understand what this means for us as payment processors.

I believe that we need to resolve this issue as a matter of some urgency if we are to avoid incidents like the one highlighted above. The Iranian banks continue to send us what I describe as conditional payment instructions which for HBEU require an element of amendment by ourselves. This introduces operational risk and under FATF principles we should not be amending these payment instructions. Acceptance of these items over many years means that we are bound by the precedents currently in place, and I believe that we need to break these precedents by

1. Establishing with HBUS and OFAC the validity of the U Turn Payment principles for Iranian payments. Whether this be by U Turn or U Turn plus I would like these to be signed off by HBUS as soon as possible and certainly by no later than 31/12/02.
2. To agree a “template” payment instruction for these U Turn Payments which can be used by PCM Sales and the RM team and sent to the Iranian Banks stipulating that payments must be formatted in this way, confirming that we will be sending these via the Serial method and that any deviation from this template will be at the Iranian Banks own risk. We would also have to state that the validity of this template would be subject to any change in OFAC legislation in the US. In this way we can give ourselves a level of protection from claims relating to capital or interest which may arise from funds being sequestrated or delayed as a result of OFAC seizure.

If we cannot achieve this in the short term then I will have to recommend to my General Manager a view that processing these payments is “unsafe” and that these items should be filtered out and cancelled. This would have severe repercussions for our Groups relationship within the Iranian FIs.

FUTURE BUSINESS STRATEGY

I believe that there is a need, based upon your responses, presumably formulated in conjunction with your colleagues from Compliance for HBEU to consider its business strategy for the continuation/development of its business with OFAC regulated countries. Whilst I am told that there are significant business opportunities particularly with countries such as Iran there are also substantial Reputational and Operational Risks, not to mention Financial losses associated with it.

Continued

4

**Compliance – OFAC Issues In General And Specific To Iran**

Whilst I am not suggesting that we should discontinue these established relationships there is a need, in the light of the changing regulatory climate for us to review our position and ensure that we have a correct balance between risk and reward.

I apologise for writing at some length but there has been much happening on this front recently and I thought it appropriate to try and pull all of the somewhat fragmented information together and to share our concerns with you.

The only certainty from all of this is that we cannot delay and prevaricate in this matter for too much longer. We have seen potential losses in excess of USD 10M in the last couple of months and it is now time for HBUS to define exactly what is and what is not acceptable to them.

Your views and those of your colleagues in Compliance would be much appreciated.

Regards.

Malcolm

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From: John F ROOT  
 Sent: Tue Jun 17 15:28:16 2003  
 To: David W J BAGLEY; John ALLISON; Susan A WRIGHT  
 Subject: Re: PLC - Re "do not mention our name"  
 Importance: Normal  
 Attachments: image\_0.gif; image\_1.gif; image\_2.gif; image\_3.gif; Doc Link.htm; r0074483.tif

Further information, as requested by David.

Kind regards

John Root

----- Forwarded by John F ROOT/HQ/HSC on 17 Jun 2003 13:20 -----

Note

17 Jun 2003 15:05



From: Elisabeth Protomastro/HBUS/HSC @  
 HSCAMERICAS

Tel: 212-525-6692

Libil Son 5:17P

John F ROOT et al

To: John F ROOT/HQ/HSC@HSC  
 cc: Carolyn M Wind/HBUS/HSC@HSCAMERICAS  
 bcc:

Subject: Re: PLC - Re "do not mention our name"

The payment was initiated by PLC and received in the HBUS Delaware Funds Transfer area for processing. It stopped for review in the OFAC queue due to the originator "Meik Bank PLC". When Funds Transfer staff noted the message in the SBI field stating "do not mention our name" the payment was rejected, per our policy, due to concerns about evasion issues under the OFAC regulations. (Even if the payment qualifies as a "return", we will not process it if it contains such a message in any field on the payment.) It will be reported to OFAC as a rejected item as required under the Iranian Transactions Regulations.

I checked with our Investigations area, and they can't tell what department in PLC initiated the payment. All the instructions received on the wire appear on the payment copy attached, which include "do not mention our name" in the SBI field. Funds Transfer in Delaware does not alter the payment instructions

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HSBC OCC 8873922

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as received.

There are several reference numbers on the payment that may help you trace its processing in London. The numbers are:

IRN: [REDACTED]  
 Sender's Ref: [REDACTED]  
 SRN: [REDACTED]

In case you have trouble reading the attached payment, details are given below.

Business date: 13-Jun-2003  
 Debit: [REDACTED] HSBC Bank PLC London USD Clearing, International Division, 8 Canada Square, London  
 Credit: JP Morgan Chase Bank, NY, NY  
 3rd party: Lloyds TSB Bank PLC, London  
 BB: BNFREF [REDACTED] Please do not mention our name in it  
 ORG: MELUGBL, Mellon Bank PLC, 4 Moorgate, London  
 USD 150,000

The payment was rejected on the same day, June 13, 2003.

Please let me know if you have any other questions.

Forwarded by Elizabeth Prodomastro/HBUS/HSBC on 06/17/2003 09:32 AM

Note 17 Jun 2003 09:02

From:	Carolyn M Wind	To:	212-625-5603
Title:	Executive Vice President	Location:	482 5th Ave, Floor 07
WorkGroup:	Corporate Compliance	Room:	5010

To: Elizabeth Prodomastro

To: Elizabeth Prodomastro/HBUS/HSBC@HSBCAMERICAS  
 Subject: Re: PLC - Re "do not mention our name"

Please provide John the details of this transaction. Thank you.

Forwarded by Carolyn M Wind/HBUS/HSBC on 06/17/2003 09:01 AM

Note 17 Jun 2003 03:04

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HSBC OCC 8873923

From: John F ROOT @ HSBC      Tel: 792 25555  
 Title:      Location: 44 20 79W 5555  
 WorkGroup:      Division:      BU: E1

To: Carolyn M Wind/HBUS/HSBC@HSBCAMERICAS

Subject: Re: PLC - Re "do not mention our name"

Carolyn,

Where did it come from? Where was it processed?

Yours

John

Carolyn M Wind/HBUS/HSBC @ HSBCAMERICAS on 16 Jan 2003 16:34



Note  
 16 Jan 2003 16:34

From: Carolyn M Wind/HBUS/HSBC @ HSBCAMERICAS      Tel: 212 825 5303  
 Mon 14 Jan 2003 17:05

To: John F ROOT

To: John F ROOT/HBUS/HSBC@HSBC

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HSBC OCC 8873924

cc:  
bcc:

Subject: PLC - Re "do not mention our name"

FYI

Forwarded by Carolyn M Wind@HBUS@HSBC on 06/15/2003 11:24 AM

Note 16 Jun 2003 11:26

From:	Elizabeth Prodanescu	To:	212-525-6692
Title:	Vice President	Location:	462 5th Ave, Floor 57
WorkGroup:	Compliance	Send To:	Auto

To: Carolyn M Wind

To: Carolyn M Wind@HBUS@HSBC@HSBCAMERICAS

cc: Anne Liddy

cc: Anne Liddy@HBUS@HSBC@HSBCAMERICAS

Subject: PLC - Re "do not mention our name"

FYI, attached please find a copy of Melli payment rejected on Friday with the above message in the "EBI" field.

Forwarded by Elizabeth Prodanescu@HBUS@HSBC on 06/16/2003 11:26 AM



HBUS Fax  
06/13/2003 10:53 AM

To: BSA Fax

Subject: Distribution of 74453: Fax from "302 636 2005"

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HSBC OCC 8873925



Status: Received  
Time: June 13 2003 10:53:12  
Pages: 3  
Receiver's Name: BSA Fax  
Receiver's DID: [REDACTED]  
Receiver's ID: [REDACTED]  
Calling Fax Machine ID: 302 639 2005  
[REDACTED]

[REDACTED] = Redacted by the Permanent  
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HSBC OCC 8873926

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INTENTIONALLY  
LEFT BLANK

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HSBC OCC 8873927

From: David W J BAGLEY  
Sent: Tue Jun 17 17:31:17 2003  
To: John F ROOT  
Cc: John ALLISON; Susan A WRIGHT  
Subject: Memo: Re: PLC - Re "do not mention our name"  
Importance: Normal

John,

Regardless of the wider issue as to the applicability of OFAC to non-US persons should we be allowing a payment with this sort of instruction to be passed to HBUS, or is there in fact nothing we can do to screen for this at least pre-WOLF.

Regards

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HSBC OCC 8873928

From: ELIZABETH PROTOMASTRO/HBUS/HSBC  
 Sent: 5/4/2005 9:59:42 AM  
 To: TERESA PESCE/HBUS/HSBC@HSBC  
 CC: ANNE LIDDY/HBUS/HSBC@HSBC; GRACE C SANTIAGO-DARVISH/HBUS/HSBC@HSBC; DENISE A REILLY/HBUS/HSBC@HSBC  
 Subject: Re: Fw: Wire Payments Suspended

For the most part, the u-turns that we have processed for HBEU are fully disclosed as per the conditions stated in the attached document last December.

(Document submitted by Denise Reilly to PCM management December 2004)

The remitter, Credit Suisse Zurich, is well aware of the u-turn practice of other U.S. organizations and the requirement for full disclosure of the name and address of the originator and the beneficiary.

Please let us know if should return the funds to Credit Suisse Zurich "as per Internal policy".

Thank you.

From: Teresa Pesce on 04 May 2005 08:15

To: Elizabeth Protomastro  
 Anne Liddy  
 Subject: Fw: Wire Payments Suspended

Anne mentioned this to me yesterday. Is this standard per David's question below?

From: Marion O ROACH  
 Sent: 05/04/2005 08:11 AM  
 To: Teresa Pesce  
 Subject: re: Wire Payments Suspended

Terry,

I attach a self-explanatory exchange of correspondence forwarded to me.

What concerns me is whether the underlying action taken at your end denotes a change of policy and approach within HBUS to what I would normally expect to be cover payments.

As you are aware, there are no Group standards which require that the originator and beneficiary details go in all payments. Accordingly, Group Operation globally will not habitually require or input this information if the underlying customer instruction is received on a basis permitted by the SWIFT format and by local regulation.

If the action that has now been taken represent the change of policy on the part of HBUS, however understandable in the current regulatory environment, it concerns me that any such change of policy may not have been communicated across the Group and subject to appropriate levels of consultation with business colleagues.

Permanent Subcommittee on Investigations  
 EXHIBIT #50c

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HSBC OCC 8874710

I would be grateful if you would clarify whether there has in fact been a change of policy, as if s.o. there does not appear to have been any external consultation or notification from HSBC.

Alternatively, if the payment has been blocked because of a reference to Iran then this is understood.

Kind regards

David W J Bagley

Memo  
04 May 2005 08:21

From: Susan A WRIGHT/HQ/HQ/HSBC Tel: 7992 5554  
44 2079 925554  
Mail Size: 7846

Redacted by the Permanent  
Subcommittee on Investigations

To: Joe E BROWNLEE/BEU/HSBC@HSBC  
cc: David W J BAGLEY/HQ/HQ/HSBC@HSBC  
bcc:

Subject: Wire payment suspended re "Iran" - USD 5,912,607.82

Joe,

I have copied this one to you for attention given the size of the transaction. Regards SW

Forwarded by Susan A WRIGHT/HQ/HQ/HSBC on 04 May 2005 08:20  
Elizabeth Protomastro/HSBC/HSBC on 03 May 2005 22:02

Note  
03 May 2005 22:02

From: Elizabeth Protomastro/HSBC/HSBC Tel: 212-525-8692  
Mail Size: 2657

To: John ALLISON/HQ/HQ/HSBC@HSBC  
cc: Susan A WRIGHT/HQ/HQ/HSBC@HSBC  
Rod MOXLEY/BEU/HSBC@HSBC  
Grace C Santiago-Cervantes/HSBC/HSBC@HSBC  
bcc:

Subject: [REDACTED]

FYI, the following payment was suspended today while we request information as to the originator and beneficiary's full name and address.

3-May-2005

SRN [REDACTED]

IRN [REDACTED]

Debit: Credit Suisse, Zurich

Credit: HSBC Bank PLC London

Org: Credit Suisse

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HSBC OCC 8874711

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BBF: Bnf/Yr participation of 30,604 our ref: BAHF [REDACTED] LC No. [REDACTED]  
of Bank Mellat Iran  
USD 5,912,607.62

Though the payment appears to meet the U-turn under the Iranian Transactions Regulations, we require that the payments should be fully disclosed as to the originator and beneficiary information before processing. We know that this policy is in line with the stance of other U.S. financial institutions, such as Bank of New York and American Express. You are also aware, from past discussions, that this is required by HRLIS.

Let us know if you have any questions. Please advise on your side of the delay in processing.

Thank you.

Attachment U-Turn Conditions.doc

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HSBC OCC 8874712

From: ANDY H IM/HBUS/HSBC  
 Sent: 2/28/2008 5:21:47 PM  
 To: JOHN ALLISON/HGHQ/HSBC; SUSAN A WRIGHT/HGHQ/HSBC@HSBC  
 CC: GLORIA STRAZZA/HBUS/HSBC; ELIZABETH PROTOMASTRO/HBUS/HSBC@HSBC02; MARY A CASKIN/HBUS/HSBC@HSBC;  
 ANNE LIDDY/HBUS/HSBC@HSBC; PATRICIA DACOSTA/HFSC/HSBC@HSBC; DENISE A REILLY/HBUS/HSBC@HSBC;  
 DONALD W MCPHERSON/HBUS/HSBC@HSBC02; CAROLYN M WIND/HBUS/HSBC@HSBC  
 Subject: Rami Makhoul

Hello,

We have determined that accounts held in HSBC Cayman are not in the jurisdiction of, and are not housed on any systems in the United States. Therefore we will not be reporting this match to OFAC. Please let us know if you have any questions.

Thanks,

Andy H Im  
 AVP, AML Compliance, HSBC Bank USA, N.A.  
 452 Fifth Avenue, Tower 7  
 New York, NY, 10018

Phone. 212-525-8139  
 Fax. 212-525-6769  
 Email. andy.h.im@us.hsbc.com

Patricia Dacosta/HFSC/HSBC@HSBC  
 02/28/2008 09:01 AM

To  
 Andy H Im/HBUS/HSBC@HSBC02  
 cc  
 Michelle P Williams/HFSC/HSBC@HSBC, David Ford/PBRS/HSBC@HSBC, Amanda Wayman/HFSC/HSBC@HSBC  
 Subject  
 Re: Fw: Search #029-08 - HFSC # 1028 - Due 25 February 2008

Dear Andy

Please be advised that we currently maintain a relationship with Sello, Mohamad Makhoul in our capacity as Trustee and the individual named in your search request (Rami Makhoul) is actually a beneficiary of the Trust (his date of birth matches the individual named in your search request which is 10 July 1959). The Trust is administered by HSBC Geneva.

We raised concerns with this client in August 2007 however we were assured by David Ford that the relationship had been reviewed at Group level and a

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**EXHIBIT #50d**

gs, Inc. HSB09255892  
 HSBC OCC 8878838

decision had been taken to continue with the relationship.

I have copied in David Ford to see if he wishes to add any comments prior to you responding directly to OFAC. In the meantime, please confirm if OFAC indicated grounds for their request?

Kind Regards  
Patricia DaCosta  
Head of Compliance  
HSBC Bank (Cayman) Limited  
P.O.Box 1109 GT  
Strathvale House  
North Church Street  
Grand Cayman KY1-1102  
Cayman Islands  
Tel: (345) 914 7572

Andy H Im/HBUS/HSBC@HSBC02  
02/27/2008 05:39 PM

To  
Patricia DaCosta/HFSC/HSBC@HSBC  
cc  
Michelle P Williams/HFSC/HSBC@HSBC  
Subject  
Fw: Search #029-08 - HFSC # 1028 - Due 25 February 2008

Hi Patricia,

As this case is urgent, can you let me know the details of the account(s) in question below?

Thanks,

Andy H Im  
AVP, AML Compliance, HSBC Bank USA, N.A.  
452 Fifth Avenue, Tower 7  
New York, NY, 10018

Phone. 212-525-8139  
Fax. 212-525-5769  
Email. andy.h.im@us.hsbc.com

----- Forwarded by Andy H Im/HBUS/HSBC on 02/27/2008 05:36 PM -----

Andy H Im/HBUS/HSBC  
02/27/2008 04:39 PM

To  
Michelle P Williams/HFSC/HSBC

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Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 8878839



cc

Subject  
Re: Search #029-08 - HFSC # 1028 - Due 25 February 2008

Hi Michelle,

Can you make sure this is a positive match? This is an OFAC request. Does your client's DOB match up with the person in question? Also, can you tell me more on the account where Makhoul is the trustee?

Thanks,

Andy H Im  
AVP, AML Compliance, HSBC Bank USA, N.A.  
452 Fifth Avenue, Tower 7  
New York, NY, 10018

Phone. 212-525-8139  
Fax. 212-525-5769  
Email. andy.h.im@us.hsbc.com

----- Forwarded by Andy H Im/HBUS/HSBC on 02/27/2008 04:36 PM -----

Michelle P Williams  
27 Feb 2008 16:24

To: ICRO IIP@HSBC

Subject: Search #029-08 - HFSC # 1028 - Due 25 February 2008

Dear Colleague,

Please note that we currently maintain a relationship with "Rami Makhoul" as Trustee of a established trust.

Kindly confirm what actions if any HSBC Group has taken in relation to the above mentioned individual.

Sincerely,

Michelle Williams  
Internal Control Officer - Compliance  
HSBC Bank (Cayman) Limited  
2nd Floor, Strathvale House North Church Street  
Grand Cayman KY1-1107  
Direct Line: 345 914 7560

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Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 8878840

From: Susan A WRIGHT  
 Sent: Wed Mar 10 14:56:49 2004  
 To: David W J BAGLEY  
 Subject: Re: BankMarkazi Payment  
 Importance: Normal  
 Attachments: image\_0.gif; image\_1.gif; image\_2.gif; image\_3.gif; Doc Link.htm

David,

As requested SW

----- Forwarded by Susan A WRIGHT@HBC on 10 Mar 2004 14:56 -----

Memo



From: Malcolm C EASTWOOD@HBC

Tel: 799 12300

44 207 691 2000

Wed 5:05 PM '04

Quentin R AYIWARD et al

To: Quentin R AYIWARD@HBC@HBC  
 cc: Phil BAINE@HBC@HBC  
 Geoff ARMSTRONG@HBC@HBC  
 Rod MCXLEY@HBC@HBC  
 Susan A WRIGHT@HBC@HBC  
 bcc:

Subject: Re: BankMarkazi Payment

Q,

Thanks. Having reviewed the attachments and the payment itself I have asked Rod Moxley to ensure that it is paid with immediate effect.

Regrettably we are now reaping the rewards of the inability of IBL and Compliance to resolve the Iranian payment issues for in excess of 12 months. We in CSD now have the tools to identify both potential Sanction and Terrorist payment activity and we have to use them and protect the Bank from financial loss and reputational risk, therefore I have no issue with the action taken by RMS.

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HSBC OCC 8873979

The information about stage payments gives some comfort although in my opinion OFAC would be perfectly within their rights to sequester this item. It is only the beneficiary name and repeat nature of the payment which will perhaps mitigate this risk. It is on the basis that if this is sequestered the risk is IBLs or its customer. I am making the payment.

On the wider issue of Iranian payments in general I remain extremely uncomfortable with the practice of amending Iranian payment orders for whatever means. Although much of this activity is historic the political climate has moved on and such practices are no longer acceptable to the regulatory authorities. On this basis I would urge both Compliance and IBL to get this issue resolved as soon as possible. My own Compliance certificate is heavily caveated to reflect what we are not compliant in respect of Iran and this will become a problem for me if we have not progressed a solution when I am asked to sign the next one.

I regret that until we achieve clarity on this issue we will continue to see items delayed and debated. Clearly I have no wish to jeopardise good relationships with IBL customers but whilst this matter remains in my pending file I am left with little choice but to hold and challenge these items on a case by case basis.

Regards,

Malcolm

Maria WYATT/HSEU/HSBC on 10 Mar 2004 11:18



Micro  
10 Mar 2004 11:18

From: Maria WYATT/HSEU/HSBC

Tel: 7991 2764  
44 2070 612734

View page 1 of 2

Malcolm G EASTWOOD c.c.

To: Malcolm G EASTWOOD/MDBK/HSBC@HSBC  
cc: Phil BAINES/MDBK/HSBC@HSBC  
Geoff ARMSTRONG/HSEU/HSBC@HSBC  
bcc:

Subject: BankMarkazi Payment

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HSBC OCC 8873980

This is a classic. I am sure that you are aware that Bank Markazi is the Iranian Central bank. From the information given the ultimate beneficiary is in America. As such it is NOT a U turn transaction thus I have some sympathy for the position taken. But in reality it is a credit to a Supra national which operates without country barriers. I however find it hard to believe that we should stop a repayment [REDACTED]

Q.

----- Forwarded by Marie WYATT@HCB@HSBC on 10 Mar 2004 11:12 -----

Memo

10 Mar 2004 10:57



From: Nigel J WEIR@RM ID MEM@HCB@HSBC

Tel: 971 4 5077622

Page 3 of 3

Sent by: Sheng Z SIDDIQI

David W J BAGLEY et al

To: David W J BAGLEY@HCB@HSBC  
cc: David H HODGKINSON@HCB@HSBC  
John BLANTYRE@HCB@HSBC  
Tim M FVANS@HCB@HSBC  
Quentin R AYLWARD@HCB@HSBC  
Brian W RICHARDS@HCB@HSBC  
bcc:

Subject: BankMarkazi Payment

David,

As Nigel is currently travelling, I enclose a self-explanatory memo from Nasser Homapour for your urgent attention. It is a serious issue and we must resolve it immediately, as it may have potentially damaging effect on our relationship with Bank Markazi.

Kind Regards,

Sheng Siddiqi

Redacted Material

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HSBC OCC 8873981

Forwarded by Sharq Z SIDDIQI on 05/10/2004

10Mar2004

Memo



To: Nigel J WEIR/RM IN MEM/HBME/HSBC.cta

To: Nigel J WEIR/RM IN MEM/HBME/HSBC  
cc: David M HODGKINS/DOCH MEM/HBME/HSBC@HSBC  
John BLANTHORN/ED CB MEM/HBME/HSBC@HSBC  
Tim M EVANS/HEAP/HSBC  
bcc:

From: Nasser HOMAIPOUR Tel: 98 21 2040467

Our Ref: Your Ref:

Subject: Bank Markazi Payment

Nigel,

We are facing a critical issue with the Central Bank of Iran whereby a regular payment comprising an instalment for a [REDACTED] is being withheld in London on the basis that it contravenes OFAC sanctions. This is a repeat payment and to date it has always been passed. It would appear that a change in the 'scanning' of transactions by the system in London has flagged it out as being worthy of investigation. This saga has been on going since SFEB04 and the Central Bank is becoming increasingly irritated with the stance taken by HSBC in the UK. The transaction actually involves 2 HSBC accounts and therefore does not involve a 3rd party bank. The delay in the payment of the instalment is causing delays in other [REDACTED] in favour of Iran which will only become effective once this final instalment is effected.

The blockage appears to have been caused by Jenette King in Compliance. Can I suggest you send an LN to Bagely highlighting the impact that this intransigent position will have on our efforts to grow business with Bank Markazi.

For ease of reference, here are the transaction details:



Best Regards,

Nasser

Redacted Material

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HSBC OCC 8873982

From: Malcolm G EASTWOOD  
 Sent: Thu Mar 11 18:37:32 2004  
 To: David W J BAGLEY  
 Cc: Quentin R AYLWARD; Phil BAINES; Geoff ARMSTRONG; Rod MOXLEY; Susan A WRIGHT  
 Subject: Memo: Re: Bank Markaz Payment  
 Importance: Normal  
 Attachments: image\_0.gif

David,

Thank you. I do understand the complexities having been embroiled in them for many months myself, but my team are placed in an impossible position. We either have to pay or return items on a daily basis and given the lack of clarity I am sure that you can understand my concerns.

My note merely seeks to raise awareness of an issue which in terms of resolution appears to have gone uncomfortably quiet of late but is very much alive in the world of payments. I take some comfort from your note and that we have a legal opinion. Hopefully we can share the contents shortly and finally produce something workable for all concerned.

With kind regards,

Malcolm

David W J BAGLEY/HQ/HSC on 11 Mar 2004 11:52



Memo

11 Mar 2004 11:52

From: David W J BAGLEY/HQ/HSC  
 Tel: 7991 8645  
 44 2078 918645  
 Work Email: 1995

Sent by: Marion O ROACH

Malcolm G EASTWOOD et al

To: Malcolm G EASTWOOD/ADB/HSC@HSC  
 cc: Quentin R AYLWARD/MSK/HSC@HSC  
 Phil BAINES/MSK/HSC@HSC

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Permanent Subcommittee on Investigations  
 EXHIBIT #52

HSBC OCC 8873985

Geniff ARMSTRONG/HBEU@HSBC@HSBC  
 Rod MOXLEY/HBEU@HSBC@HSBC  
 Susan A WRIGHT/HBEU@HSBC@HSBC  
 bcc:

Subject: Bank Marazzi Payment

Malcolm

I have had sight of your note of 10 March.

Whilst I understand your concerns, which I share, particularly when taking a Group view, I believe your note rather underestimates the complexity of the OFAC regulation, and the competing competitive pressures across the Group.

The complexity of the OFAC regulations, and the fact that HBUS were unaware that any arrangements existed with Iranian Banks, has made speedy resolution of this issue difficult.

A legal opinion has now been obtained from American lawyers, and a recommendation will be made shortly with regard to what we would hope will be a compliant approach, which reflects both the regulatory situation, seeks to address the compelling competitive driver, and hopefully also addresses the political risks.

It is not that Compliance is unable to find a solution, rather the solution is anything but easy to arrive at.

Regards

David Bagley

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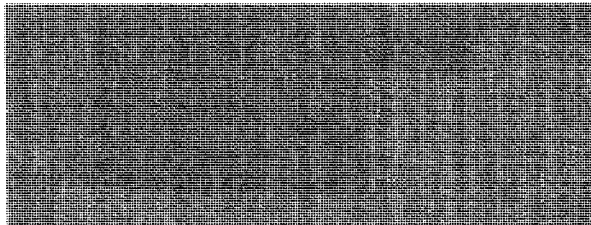
HSBC OCC 8873986

From: Marion O ROACH  
 Sent: Mon Apr 19 13:40:17 2004  
 To: Richard E T BENNETT  
 Subject: Iran Correspondent Banking Services - OFAC  
 Importance: Normal  
 Attachments: image\_0.gif; image\_1.gif; Doc Link.htm

Richard,

I refer to your note concerning the above, and attach the results of a recent exchange of correspondence with David Hodgkinson on this subject. You may recall that we discussed this matter in our previous meeting with SKG where he gave a clear indication that Martin Glynn's views should be sought before there was any expansion of activity in relation to Correspondent Banking services for Iranian Banks.

My note of 22MAR04 to David was intended to ascertain exactly what was intended, although as you will see, I have received a slightly opaque response.



I will follow up with Warren in terms of the work David says is underway, but as you will see the most pressing issue to be resolved is that relating to the limited number of existing relationships that we have (for two small Iranian Banks) where I suspect that HBUS are not aware that payments may be passing through them. Do not believe that we can allow this situation to continue very much longer, which is the point I will make to David in my response.

I recognise that there is a need to act on SKG's suggestion for a solution. It occurs to me however that this solution may not be workable given the multiplicity of pointers involved. We are dealing with payments for the customers of Iranian Banks. These will not therefore lend themselves to a vetting approach given that we will have no control over who acts for the various remitters and beneficiaries.

Kind regards

Permanent Subcommittee on Investigations

EXHIBIT #53

Redacted Material  
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HSBC OCC 8873994





## Memo

22 Mar 2004 16:54

From: David W J BAGLEY/MHQ/HSBC

Tel: 7991 8045

44 2079 918645

Mob: 910 5745

Sent by: Marion O ROACH

David H HODGKINSON et al

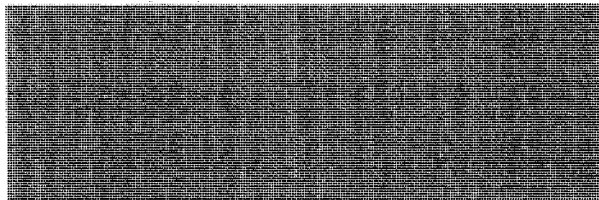
To: David H HODGKINSON/DCH MEM/HME/HSBC@HSBC

cc: Warren G LEAMING/RLA LGA MEM/HME/HSBC@HSBC

bcc:

Subject: IRAN - CORRESPONDENT BANKING SERVICES

David



Whilst the above steps are possible, it is likely that HBUS will need to satisfy itself that the procedures are robust and adequate given the significant regulatory and reputational risks they run if errors were to be made.



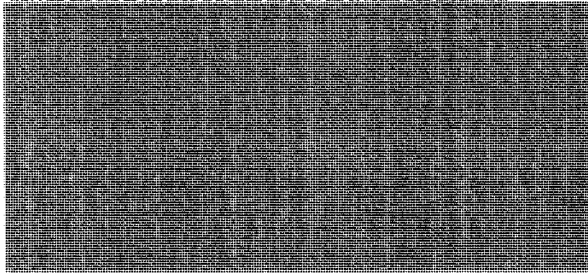
Redacted Material

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HSBC OCC 8873995

[REDACTED] I am uncomfortable with this activity in its current form and think that we need to make an early decision both with regard to this business and the extent to which we wish to expand our activities involving Iranian banks.

I spoke personally to the US lawyer who has provided us with advice, and separately with Paul Lee who as you know is a senior lawyer in our in-house legal department.



My reason for writing to you at this stage is that I think it would be sensible for us to make an early commercial decision before we spend any more money on legal opinions, or in upgrading our activities in the UK so as to achieve a compliant approach. My sense of the value of the existing business is that it is relatively modest. When I spoke to Nigel Weir, my recollection is that he was talking about the value of increased business as being some USD3m. If these figures are accurate, then the amount of revenue may not justify either the additional work and investment that will be required, nor would it justify running the reputational and regulatory risk in the US. I recognise however the significance of this activity in terms of our image in Iran and our ability to expand our business there.

I would be happy to discuss this issue more generally with you if that would help, although suspect that perhaps the next conversation you might wish to have would be with Martin Glynn. Could I suggest however that any such conversation take place over the telephone, as we are seeking to avoid correspondence with HBUS on this sensitive issue other than through lawyers so as to preserve privilege.

I would stress that I do think we need to make an early decision given the current activity that is taking place.

Regards

Redacted Material

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HSBC OCC 8873996

David Bagley

---



Memo

17 Apr 2004 07:55

From: David H HODGKINSON/DCH MEM/HBME/HSBC

Mail Size: 2547

---

David W J BAGLEY et al

To: David W J BAGLEY/HGHQ/HSBC/HSBC

cc: Manton O ROACH/HGHQ/HSBC/HSBC

Warren G LEAMING/RLA LGA MEM/HBME/HSBC/HSBC

bcc:

Subject: Re: IRAN - CORRESPONDENT BANKING SERVICES

David

I have been in regular contact with Mukhtar Hussain and his team on this topic which is still open. The current position as briefed to me last week was that we have not yet found a way to handle major USD clearing business, and I am anticipating having to explain this to the Central Bank on my visit to Teheran in early May. I have asked our people to put forward the basis on which they believe this could be undertaken with the lowest level of perceived risk, so that if circumstances change we know our preferred way forward.

Regards

David

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HSBC OCC 8873997

From: David H HODGKINSON  
 Sent: Wed Jun 30 11:50:21 2004  
 To: Michael F GOGHEGAN  
 Subject: Memo: Re: Iran  
 Importance: Normal  
 Attachments: Doc Link.htm

Michael,

I should be grateful for your assistance with an issue relating to the processing of USD payments for Iranian Banks.

You may be aware that, together with your payments team and GHQ Compliance, we have been working for some time to try and establish a practical solution which will enable HBEU to continue processing USD payments on behalf of our Iranian Bank customers. [REDACTED] Until a definitive solution is found GHQ Compliance granted a temporary dispensation to HBEU to continue making payments without full disclosure. This dispensation cannot last indefinitely.

[REDACTED] HBEU's payments team have advised that they feel uncomfortable recommending continuation of this business and unless compelling commercial reasons exist will be advising relevant parties that this business will cease on 30/9/04.

You will note from the attached correspondence that we have appealed and the reasons have been articulated. I am now seeking your intervention and support in resolving positively this long outstanding issue so that we can continue to effect USD payments for our Iranian Bank customers in line with US regulatory requirements. I am aware that the volume of payments is small (20 per day) and that they will be manually intensive but as you know Iran is of significant strategic importance to the Group and our refusal to continue to undertake this business for Government owned banks will undoubtedly have a very negative impact.

Thank you in advance

David  
 ----- Forwarded by David H HODGKINSON/DCH MEM/HBE/HSBC on 06/30/2004 03:47 PM -----

Nigel J WEER  
 RM TB MEM/HBE  
 30 Jun 2004 14:50  
 971 4 5077632

To: Rod MOXLEY/ROD@HSBC@HSBC

Redacted Material  
 Confidential - FOIA Treatment Request

Permanent Subcommittee on Investigations  
 EXHIBIT #54

HSBC OCC 8874001

cc: David H HODGKINSON/DCH MEM/HBME/HSBC@HSBC  
 Mukhtar M HUSSAIN/CEO IB&M HFSM/HBME/HSBC@HSBC  
 Geoff ARMSTRONG/HBEU/HSBC@HSBC  
 Phil BARNES/MDBK/HSBC@HSBC  
 Nassor HOMAPOUR/HSBL/HSBCAPAC@HSBC  
 John ALLISON/HGHQ/HSBC@HSBC  
 Susan A WRIGHT/HGHQ/HSBC@HSBC  
 Warren G LEAMING/RLA LGA MEM/HBME/HSBC@HSBC  
 John E RCOO/HBEU/HSBC@HSBC  
 Gary BOON/MGR PCM MEM/HBME/HSBC@HSBC  
 Ajay BHANDOLAR/M PCM MEM/HBME/HSBC@HSBC  
 Malcolm G EASTWOOD/MDBK/HSBC@HSBC  
 Simon R VICKERY/HBEU/HSBC@HSBC  
 Jeremy H WALKER/HBEU/HSBC@HSBC  
 Tony P COLLINS/HBEU/HSBC@HSBC  
 Subject: Memo - Re: Iran  
 Your Ref.  
 Our Ref.

Re:

Thank you for your note. I would ask you to reconsider your suggested proposal as there are very compelling commercial reasons which need to be borne in mind when making this decision, not least of which is the threat to the Group's position in and business with Iran over the medium term.

You may be aware that the Iranian Banks that use HSBC for these payments are State owned banks. If we advise them that we will no longer continue to process these payments we will be effectively insulting the Government and State of Iran. The implication of this action is difficult to predict with certainty but we expect that it will adversely impact our overall business with Iranian banks and, more importantly, our operations in Iran. In the current sensitive political situation we have declined to accept new USD payments business from Iranian banks but to exit business which we have been conducting for many years would jeopardise all other existing business activities. It will specifically impact the servicing of our trade business with Iran where our current turnover is in excess of USD1bn p.a. For your information, overall, the Group earns about USD10M p.a. from these business activities.

We believe the low volumes are reasonably cost effective to control and as such I should be grateful if you could revisit this issue and, working with Group Compliance (and the PCM team in HBME Dubai if appropriate), prepare a solution which will enable HBEU to effect USD payments in accordance with US regulations for our Iranian Bank customers. GHQ Compliance can then present this to HBUS for their consideration.

Thank you and Regards

Nigel

09Jan2004

Memo

To: John ALLISON/HQ/HBSC@HSBC  
 cc: Susan A WRIGHT/HQ/HBSC@HSBC  
 John E ROOY/HBSC@HSBC  
 Nigel J WELSH/10 MEM/HBSC@HSBC  
 Gary BOONMGR PCM MEM/HBSC@HSBC  
 Malcolm G EASTWOOD/MD/K/HBSC@HSBC  
 Simon R VICKERY/HBSC@HSBC  
 Jeremy R WALKER/HBSC@HSBC  
 Tony P COLLINS/HBSC@HSBC  
 bcc:

From: Rod MOXLEY Tel: 799 13664, 44 20 7491 3664

Our Ref: Your Ref  
 Subject: Iran

John,

I have reviewed US Counsel's proposed solution on Iranian U-turn payments and my brief opinion is as follows.

Operational difficulties

i) Duplication of payments.

The suggested procedure will involve much additional detail on the MT202s and it is my belief that this additional detail may lead to some recipients treating this as a direct payment rather than the cover of an original payment. Duplication of payment may result.

ii) Global market practice.

The procedure we would now be adopting would be at variance with standard market practice and this in itself could produce processing problems.

iii) STP.

The suggested procedure would lead to more manual intervention, greater cost and potentially less control, as 3 or 4 different sites can be involved in the processing of any transaction. The level of control which RMS could exercise over each payment diminishes as payment processing is divided between RSC (NHQ27), EPS (Livangaon) and GSC (India).

iv) Other US banks.

The stance of other US banks who have withdrawn from the Iranian market means that we are still in a vulnerable position if our customers are asking us to give guarantees that payments will reach their ultimate destination without problem.

v) U-turn payments criteria.

The definition of what constitutes a U-turn payment is open to interpretation and the accuracy of information on the OFAC website has also been questioned. This can lead us on occasions to making subjective decisions.

Redacted Material

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HSBC OCC 8874003

which could lead to operational losses or reputational damage.

**Proposal**

For the reasons stated above, I feel very uncomfortable recommending that we continue to process Iranian payments. It is possible to continue but the higher level of costs, the reduction of control, possible systems enhancements and the potential for error make this unattractive.

We have discussed this situation at length and so, rather than re-open another round of talks, I should be grateful if you could let me have your formal response, (and that of any other interested copy parties to this email) by Friday 18th June 2004.

Therefore, unless compelling commercial reasons exist, which have been endorsed by Group Compliance and HSBN, I shall be formally advising interested Relationship Managers that we will no longer be able to handle Iranian payments after 30 September 2004.

Regards

Red Mesley  
Regulatory and Operational Risk Manager

<<\_>>

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HSBC OCC 8874004

From: John RANALDI  
 Sent: Wed Jan 30 12:23:23 2004  
 To: Michael F GREGGHEGAN  
 Subject: Memo: Re: Fw: Iran  
 Importance: Normal

Mike, I was aware of this. Will get an update and let you know. Basically, our interpretation was that we were being asked to "fudge" the nature of the payments to avoid the U.S. embargo and seizure a few days.  
 JT

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Permanent Subcommittee on Investigations  
 EXHIBIT #55

HSBC OCC 8873999



From: John RANALDI  
 Sent: Tue Jul 06 15:07:22 2004  
 To: Michael F. GREGG  
 Subject: HBEU Iranian Payments Business  
 Importance: Normal  
 Attachments: IRANIAN PAYMENT - EXECUTIVE SUMMARY.doc; IRANIAN PAYMENT PROCESSING PROPOSALS.doc

Michael, reference your earlier query.  
 This is clearly not a simple matter. Our posture has been to respect the law and our bank's reputation. We are being asked to amend instructions or, assume responsibility that the contents of the payment message do not attract the Fed's attention and seize the payment. We should not take on that responsibility. Essentially, a payment clerk is asked to judge upon a payment kicked out by the filtering system, whether to reissue, or return. There is an irony: someone could argue that by returning payments to Iran that we are contravening the old rule (office of foreign asset control). Today we run the risk of 1) having the payment seized and incurring the operational loss, and 2) jeopardising the group's reputation and incurring hefty fines even if we receive an indemnity. Our people would continue to be asked perhaps to decide whether a payment is acceptable despite being kicked-out by the filtering system. So as to avoid seizure, we will make mistakes. Boyd has been fixed in mind and few if any U.K. banks are in the business. We may discuss at your leisure. I will bring the experts.

JF

----- Forwarded by John RANALDI@HBEU@HSBC on 06 Jul 2004 14:48 -----  
 Malcolm G EASTWOOD@MDBK@HSBC on 06 Jul 2004 14:26

Memo  
 06 Jul 2004 14:26

From: Malcolm G EASTWOOD@MDBK@HSBC Tel: 799 12300  
 44 207 991 2300  
 Mail Size: 94011

To: John RANALDI@HBEU@HSBC@HSBC  
 cc: Paul N CONROY@HBEU@HSBC@HSBC  
 Rod MOXLEY@HBEU@HSBC@HSBC  
 bcc:

Subject: HBEU Iranian Payments Business

John

Please find attached a detailed note on the subject of Iran. I have attached to this email a one page Executive Summary which provides the headlines

This is an extremely sensitive area. To date we have steered away from detailing exactly what we are doing with these particular payments because of the sensitivities. I would certainly counsel against a wide distribution and we should definitely resist any move to send the detail to anyone in RBUS as it may well compromise their position with the US Authorities.

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Permanent Subcommittee on Investigations  
 EXHIBIT #56

HSBC OCC 8876861

The Fed would certainly frown on any process either deliberately or accidentally designed to prevent the legitimate sequestration of Iranian funds under OFAC rules which is why we currently use the Wolf filter to identify potential terrorist related payments and not to block other payments. The proposals are written to reflect an adjustment in the use of Wolf to check that Iranian payments are legitimate U Turn items and then to release these rather than any attempt to prevent US legislation doing its job which might then compromise the Groups US licence. It also places the risk and responsibility for ensuring payment legitimacy fairly with the Iranian FI community rather than with ourselves.

This is a difficult area for many reasons, not the least of which is the fact that the OFAC regulations relating to Iran tend to be grey and are subject to different interpretations by the US banks. In this proposal we are attempting to walk a difficult path between protecting our US licence whilst also preserving a not insubstantial income stream and future potential income stream from Iran. The safest option from my perspective would be to exit the Iranian FI payments business as indeed others have but in the knowledge that this will denude our income stream Rod and I have tried to build an alternative solution.

Please let me know if you wish to discuss.

Malcolm

----- Forwarded by Malcolm G EASTWOOD/MDBK/HSBC on 06 Jul 2004 13:56 -----  
Rod MOXLEY/HBEU/HSBC on 06 Jul 2004 13:35

Meine  
06 Jul 2004 13:35

From: Rod MOXLEY/HBEU/HSBC Tel: 799 13664  
44 20 7991 3664  
Mail Size: 54054

To: Phil BAINES/MDBK/HSBC@HSBC  
cc: Geoff ARMSTRONG/HBEU/HSBC@HSBC  
Malcolm G EASTWOOD/MDBK/HSBC@HSBC  
Bob A WESTON/HBEU/HSBC@HSBC  
Jeremy R WATKINSON/HBEU/HSBC  
Tony P COLLINS/HBEU/HSBC@HSBC  
bcc:

Subject: Iran

Phil,

Further to recent discussions with Malcolm regarding potential solutions for the Iranian payments issue, I attach a document encompassing a potential way forward. I shall be pleased to have your comments in due course or, if you

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843

feel it appropriate, we can discuss over the phone.

Regards

Rod Mooley  
Regulatory and Operational Risk manager, Payment Services

<<.,>> <<.,>>

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HSBC-BNL\_E 0067605.txt

From: DENISE A REILLY/HBUS/HSBC  
 Sent: 11/30/2004 3:00:54 PM  
 To: SANDRA PETERSON/HBUS/HSBC@HSBC  
 CC: "MICHAEL GALLAGHER" <MICHAEL.B.GALLAGHER@US.HSBC.COM>  
 Subject: Re: Fw: U-turns

Thanks for reviewing. My responses are in blue on the attached.

I'll let you know what comes out of the meeting.

Sandra Peterson on 30 Nov 2004 14:42

Note  
 30 Nov 2004 14:42

From: Sandra Peterson Tel: 302-636-2500  
 Title: Senior Vice President Location: Delaware/3, Floor 3  
 WorkGroup: Central Services Mail Size: 10546

To: Denise A Reilly/HBUS/HSBC@HSBC

cc: "Michael Gallagher" <michael.b.gallagher@us.hsbc.com>  
 Subject: Re: Fw: U-turns

Denise, thanks for re-sending the doc. Just a few questions:

It is my understanding that initially there were concerns about the potential intentional removal of wording "off limit payments" from these payments. Based on what we are being asked to do now, has that concern been addressed? I'm not familiar with the use/removal of "off limit payments" but the recommendation from a legal and compliance perspective is to have full disclosure of all parties and payment details. HSEU would be advised to not alter the payment details in any way.

Is this proposal for Bank Melli only or is the intent to grow this business? When this topic first arose it was to support Bank Melli but my understanding is that the business under discussion now is more general, with no specific clients named to date. I also heard sometime ago that Bank Melli established a relationship with another institution for their USD correspondent needs. I

Page 1

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Confidential Treatment Req

Permanent Subcommittee on Investigations  
**EXHIBIT #57**

BC-PSI-PROD-0096165

HSBC-BNL\_E 0067605.txt

don't think the volume of transactions would be comparable to what was discussed for Bank Mellat (400/day).

Out of curiosity, how did legal respond (internal and external)?  
Legal advised that we should have full disclosure of payment details and ensure appropriate controls were in place. However, the final decision on accepting the payments was viewed as a business decision.

Thanks,  
Sandra

From: Denise A Reilly on 30 Nov 2004 07:09

To: "Sandra Peterson" <sandra.peterson@us.hsbc.com>

cc: "Michael Gallagher" <michael.b.gallagher@us.hsbc.com>  
Subject: Fw: U-turns

I'm not sure if you are aware that the possibility of doing U-turn transactions has been raised once again as a business initiative. This topic has come up several times since 2001. Terry Pesce was asked to meet with Martin Glynn on the topic and she asked Michael and I to join her (today at 4pm). In preparation, attached are the required control procedures for doing such transactions. The document was developed with Anne Liddy and Carolyn Wind and was vetted by external counsel when the topic was last active in 2001-2002. Please let me know if you have any comments or concerns from a Payment Ops perspective.

Thanks.

From: Michael B Gallagher  
Sent: 11/29/2004 09:22 PM  
To: Denise Reilly  
Subject: Re: U-turns

Has Sandra not reviewed?

Page 2

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Confidential Treatment Requested HSBC-PSI-PROD-0096166

846

HSBC-BNI\_E 0067605.txt

From: Denise A Reilly  
Sent: 11/29/2004 07:45 PM  
To: Michael Gallagher  
Cc: Teresa Pesce; Grace C Santiago-Darvish; Alan T Ketley  
Subject: U-turns

Attached are the control procedures (slightly updated) that I put together when I was in Payments. This should be part of our discussion with Martin tomorrow. Give me a call if you would like to discuss before our 4pm.

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Confidential Treatment Requested HSB0-PSI-PROD-0096167

From: DENISE A REILLY/HBUS/HSBC  
 Sent: 12/27/2014 4:38:01 PM  
 To: MICHAEL B GALLAGHER/HBUS/HSBC@HSBC  
 CC: TERESA PESCE/HBUS/HSBC@HSBC; SANDRA PETERSON/HBUS/HSBC@HSBC; GRACE C SANTIAGO-DANVISH/HBUS/HSBC@HSBC  
 Subject: U-Turns

Attached are the conditions under which HBUS will accept U-Turn transactions. I have reviewed with Sandra and Grace.

Please call if you have any questions or need additional information.

Attachment: U-Turn Conditions.doc.zip

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Permanent Subcommittee on Investigations  
 EXHIBIT #58

js, Inc. HSB03793168  
 HSBC OCC 3407526

**HBUS Conditions for Processing U-Turns**

Agreement to the following conditions is required for HBUS to accept U-Turn payments.

- Transactions will be formatted in accordance with SWIFT standards and will be fully transparent serial payments that reflect full payment details. Payments must include complete name, street address, city and country of the originator and beneficiary.
- HBEU will agree to strictly abide by U-turn processing requirements (to be provided by HBUS) and will not alter "as received" payment instructions in a manner other than that required to meet payment formatting requirements. Payment details will in no case be dropped from the instructions forwarded to HBUS.
- HBEU will indemnify HBUS for all potential penalties that may result from violations of OFAC sanctions, regardless of the cause and source of the action that precipitated the violation.
- A separate processing account will be established under the name of "HBEU Special Account" on HBUS books. Only Iranian originated transactions will pass through this account.
- The account number of "HBEU Special Account" will be entered into the HBUS payments system OFAC filter so that every transaction for this account will be stopped in the OFAC queue for review and approval before processing.
- HBUS will be reimbursed for any additional FTE's required due to increased process burden attributable to OFAC review of Iranian payments.
- HBUS pricing for the transactions will reflect incremental processes and risk.

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From: David H HODGKINSON  
 Sent: Mon Jun 27 11:29:30 2005  
 To: David W J BAGLEY  
 Cc: Richard E T BENNETT  
 Subject: Re: IRANIAN PAYMENTS  
 Importance: Normal

David,

By way of update, HBME is currently seeking to open a USD account with JP Morgan Chase as our first choice (or Bank of America as second choice), in order to process Iranian related USD payments. Whilst JPMC have verbally agreed to open the account they have warned us that any cover payment could be subject to their compliance process whereby they would seek full details of the underlying transaction either before or after processing. There could be a risk of referral to OFAC should their interpretation of a U-Turn transaction be different to ours. We have been advised that an account could be opened within a few weeks should we proceed down this road.

At the same time, new USD accounts for our Iranian correspondents will have to be opened with HBME in Dubai, which will have to be communicated, with the assistance of our Tehran office, in order to get their USD payments re-routed appropriately. We will also need to establish procedures in order to ensure compliance with OFAC regulations regarding U-Turn payments, which involves an operational review and staff training. With London's assistance, this should be completed by early September.

I note your comments in point 2 with interest as we never envisaged anything other than U-Turn compliant payments being processed. Accordingly we agree that there is no reason to use anyone other than HBUS and can confirm that there is no misunderstanding in this regard. I understood that the only reason we considered using another US correspondent was purely because HBUS had shown an unwillingness to process these transactions for regulatory risk reasons. Having considered this further it appears to us that using another correspondent may not completely overcome the reputation risk issue.

When the USD accounts of Iranian banks are opened in Dubai, HBME will take over the payments from HBEL. We will establish a specialist team to manually review each transaction (including routing them through WOLF) ensuring they are U-Turn compliant. We intend to continue with the cover payment method as our understanding is that if serial payments are used other US banks in the chain may interpret the U-Turn process differently which may lead to delays and other problems as payments are referred mistakenly to OFAC. We envisage providing HBUS separately with full details of each payment (not in a manner to avoid duplication) so that they are in a position to satisfy themselves and anybody else that the payments are genuine compliant transactions.

For the sake of clarity we would repeat the definition of a U-Turn payment defined by OFAC on their website as a payment "...involving Iran where US Dollar transactions are cleared through a US bank. Generally speaking, there must be a third-country bank on both sides of a transaction to qualify as a 'U-Turn'. For example, Bank Mellat Iran can send funds from its account at a German bank through the German bank's correspondent in New York to an Italian

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Permanent Subcommittee on Investigations  
 EXHIBIT #59

HSBC OCC 8878026

850

bank to pay for goods purchased from Italy. The originating and beneficiary banks may not be US banks."

In light of the position, assuming that the decision to use another bank is re-visited and the above process is acceptable to HBUS and yourselves, HBME will be happy to meet HBUS counterparts to provide them with any further confirm or explanation that they require. I have not copied this message to Stephen Green as your message was not.

Your thoughts and guidance will be appreciated.

Regards,

David

David W J BAGLEY  
HGHQ  
20 Jun 2005 19:27  
;7991 8645;44 2079 918645  
Sent by: Marion O ROACH

To: David H HODGKINSON/DCH MFM/HBME/HSBC@HSBC  
cc:  
Subject: IRANIAN PAYMENTS  
Our Ref:  
Your Ref:  
Entity: HSBC Holdings plc - HGHQ

David

The above topic surfaced in the routine meeting which Richard Bennett and I

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HSBC OCC 8878027

had with Stephen in advance of the monthly GMB meeting.

Stephen raised with me the following points:-

He sought my assurance that the agreed arrangements in relation to Iranian payments had been put in place. For obvious reasons I was not able to give that confirmation but did emphasise that in failing to do so I was not suggesting that the arrangements were now in fact complete. I thought it only right and proper however to alert you to the fact that Stephen is looking for confirmation that all payments are not being routed through HBME via a non-Group clearer, or that a reasonably proximate date has been set by which time those arrangements will be in place. This sense of urgency is possibly explained by the information contained in the third bullet point below.

Stephen also asked for confirmation that the payments that would pass through the US would all be payments which were U-turn exempt even if they went through the US in the form of a cover payment. Although I may have misunderstood our discussions I was not previously aware that this was a precondition nor did my original paper envisage that if we used a non-Group correspondent we would necessarily consider passing only U-turn exempt payments through them. In fact in such circumstances there would be no reason to use anyone other than HBUS given that HBUS could not be criticised were it to carry out exempt payments. I would be grateful if you would confirm that there is no misunderstanding in this regard and that we will only be passing payments through the US, whether or not through our own correspondent, that we have validated as being U-turn exempt. If this not the intention then I suspect some further discussions with Stephen may be required.

I understand this point, but believe that we also need to consider the extent to which we are at risk if we fail to consider the transaction as a whole (i.e. both the cover payment instruction and any linked bank to bank message) which if put together would lead to a different determination in terms of that U-turn exemption.

The reason for my additional caution is that I had a number of discussions at a recent Wolfsberg meeting which raised my concerns with regard to the level of scrutiny that US authorities are giving to cover payments generally but also specifically in relation to OFAC compliance on the part of US banks offering correspondent banking services.

One major European entity has made a decision to apply OFAC regulation and restrictions across the entirety of its operations, inside the US and outside, in all currencies. Although they were hesitant in explaining their reasons for taking this decision I suspect it is because they have had recent fairly well-publicised difficulties with OFAC compliance.

Another European institution indicated that they were facing a criminal prosecution in the US for deliberately evading OFAC sanctions by failing to link a cover payment and an underlying bank to bank message together thus

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HSBC OCC 8878028

allowing the sanctions to be evaded. Admittedly their activity appeared to have been through their own correspondent branch in the US, and I was unable to elicit any further details. Nonetheless this does seem to me to justify further scrutiny and consideration on our part.

As I may have mentioned the US regulatory authorities, OCC and Federal Reserve, are carrying out a joint peer review of correspondent banking from an AML and OFAC compliance perspective. The visit to HBUS will commence shortly if it has not already commenced. As part of that review I believe that the US authorities have focused upon cover payments both in relation to AML procedures but also in relation to OFAC compliance. I believe that a potential account of the scrutiny and the resultant recommendations will be an expectation that US banks should not merely accept cover payments without seeking full details of any underlying transaction. That would of course mean that we would probably be required to disclose both details of the cover payment and the linked message to any US correspondent we employ even if they were a non-Group correspondent. I recognise that this is something primarily for the US correspondent to resolve but I suspect you may need to factor this potential development into your thought processes going forward. Of course if this is a wider requirement of all US Dollar clearers then the potential for damaging our relations with Iran would be minimised given that we are merely following restrictions imposed on all market participants by a more zealous application of US law.

I am in fact out of the office travelling on business this week. I will however monitor my BlackBerry, but it may be that you would prefer to correspond with Stephen direct with regard to the first two points on which he was seeking assurance.

If there is any news with regard to the further legal advice that is being taken then I will ask John Root to consider a joint note to us.

Regards

David Bagley  
(sent not seen by DWJB)

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HSBC OCC 8878029

HSBC-BNI\_E 0699475.txt  
 From: ROB MUTH/HGHQ/HSBC  
 Sent: 5/8/2006 11:07:51 AM  
 To: CAROLYN M WIND/HBUS/HSBC@HSBC  
 CC:  
 Subject: Fw: INFO: Fw: TP GATEWAYS

Carolyn, are you OK with this? I would have thought the US regulators would have taken a dim view of routing stuff around the US. Pls comment. Rob  
 ----- Forwarded by Rob Muth/HGHQ/HSBC on 08/05/2006 17:06 -----

Peter C L DE MONTFORT/HGHQ/HSBC  
 HGHQ  
 08/05/2006 17:00  
 Phone No. 799 23755  
 +44 (0) 20 799 23755  
 Mail Size: 5769

To  
 Rob Muth/HGHQ/HSBC@HSBC  
 CC  
 Subject  
 INFO: Fw: TP GATEWAYS  
 Entity  
 HSBC Holdings plc - HGHQ

As discussed, I am expecting the impact of this to be some delay in Panama and Mexico migrations from their current dates of 20MAY and 31JUN respectively.

David W J BAGLEY/HGHQ/HSBC  
 HGHQ  
 Sent by: Marion O ROACH  
 10/04/2006 15:58  
 Phone No. 7991 8645  
 44 2079 918645  
 Mail Size: 2830

To  
 Luis EDUARDO/HBBR/HSBC@HSBC, David Leighton/HBMX/HSBC@HSBC, Brigitte SCHIMUNEK/HBCL/HSBC@HSBC, David S DUNCAN/HBAR/HSBC@HSBC, Andy GENT/HBBW/HSBC@HSBC, Virginia SUAREZ/HBUY/HSBC@HSBC, Joseph L SALTERIO/HBPA/HSBC@HSBC  
 CC  
 John ALLISON/HGHQ/HSBC@HSBC  
 Subject  
 TP GATEWAYS  
 Entity  
 HSBC Holdings plc - HGHQ

We propose that the countries in the Americas outside USA disconnect their  
 Page 1

Permanent Subcommittee on Investigations

EXHIBIT #60

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is, Inc. HSB08071341  
 HSBC OCC 7687437

854

HSBC-BNILE 0699475.txt  
payment routing link to the USA TP Gateway and reconnect to the UK TP. This  
will provide two main benefits, firstly the ability to make payments in  
currencies other than USD to countries/names/entities sanctioned by USA OFAC  
(as permitted by GCL 050047), and secondly to take data records outside USA.  
Can you please advise John Allison by 30 April 2006 whether you agree with this  
proposal.

David Bagley

Page 2

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855

From: ALAN T KETLEY/HBUS/HSBC  
Sent: 5/26/2006 11:14:07 AM  
To: "JUDY STOLDT" <JUDY.P.STOLDT@US.HSBC.COM>  
CC:  
Subject: U Turns

Judy

Can you look at this please and help be decode it.

We are likely to be handling U turns for Dubai going forward.

Alan T. Ketley  
First Vice President, Anti Money Laundering  
Tel: 212 525 6147  
Fax: 212 382 7580  
----- Forwarded by Alan T Ketley/HBUS/HSBC on 05/26/2006 12:09 PM -----

Teresa Pesce/HBUS/HSBC  
05/26/2006 08:28 AM

To  
Alan T Ketley/HBUS/HSBC@HSBC  
cc

Subject  
Fw:

Forget what I said yesterday.

-----  
Sent from my BlackBerry Wireless Handheld

From: David W J BAGLEY  
Sent: 05/26/2006 03:29 AM  
To: Teresa Pesce  
Cc: Warren G LEAMING; Alan KERR; Gary BOON

Terry,

The attached is all I hope self-explanatory and whilst I am not suprised at the reaction from JPMC, it is important to emphasise that we are talking about exempt U-turn payments. HBME have no choice but to now pass the paymments via HBUS, but as they are exempt, you have previously confirmed with Martin that HBUS are comfortable this does not seem to me to be problematic.

I anticipate that you would prefer to see Field 72 completed, but this will mean more hits in the filters even if they will then be passed. Could you let me know and copy Gary Boon and Alan Kerr as I am out for part of today, Monday is a public holiday and I at Wolfsburg next week.

Give me a call if you need to discuss and I appreciate that you may want to

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Permanent Subcommittee on Investigations  
**EXHIBIT #61**

, Inc. HSB03629424  
HSBC OCC 3243782

recheck with Martin.

Regards

— Forwarded by David W J BAGLEY/HGHQ/HSBC on 26/05/2006 08:22 —

Alan KERR/HBME/HSBC  
HBME  
26/05/2006 06:45  
Phone No. 971 4 5077674  
Mail Size: 7618

To  
Warren G LEAMING/RLA LGA MEM/HBME/HSBC@HSBC, Ian EDEN/HBME/HSBC@HSBC, Ben  
HOLT/HBME/HSBC@HSBC, David W J BAGLEY/HGHQ/HSBC@HSBC  
cc  
Gary BOON/HBME/HSBC@HSBC, Ken C MATHESON/HBME/HSBC@HSBC  
Subject  
Fw: US Dollar Transactional Activities via DDA at JPM  
Entity  
HSBC Bank Middle East Limited

Ali,

Please see attached message received from JPMC regarding transactions acceptable for transmission through our USD account with them, which follows on from our discussion with them yesterday morning regarding our imminent move to serial payments + cover payments with Field 72 completed.

Please could you provide guidance as to how we may continue to effect OFAC U-turn compliant transactions on behalf of our Iranian customers.

Alan Kerr  
Head of Institutional Banking  
Tel : 971 4 5077 674  
Fax : 971 4 3535079

— Forwarded by Alan KERR/HBME/HSBC on 05/26/2006 09:37 AM —

Ali.Moosa@jpmorgan.com  
05/25/2006 09:49 PM  
Mail Size: 5256

To  
Gary BOON/HBME/HSBC@HSBC, Alan KERR/HBME/HSBC@HSBC  
cc  
Layla Oaseer@jpmorgan.com, Carmel Speers@jpmorgan.com, collin.j.nutt@jpmorgan.com  
Subject  
US Dollar Transactional Activities via DDA at JPM  
Entity  
HSBC Bank Middle East Limited

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Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSB03629425



Dear Gary,

It was a great pleasure speaking to you and Alan today.

First, many thanks for keeping us informed on the group decision regarding the payments method. This is to confirm that we will be pleased to continue processing HSBC's Middle East dollar payment transactions, (both MT103 and 202) with the exceptions of the Iranian referenced transactions that should be directed to other correspondent banking account. Unfortunately, as a business decision we will not be able to process such Iranian referenced details on the payment narratives.

We look forward to continuing our excellent business relationship. Please do not hesitate to contact us if we can be of any further assistance or if you have any questions.

Have a nice week end.

Ali

Ali Moosa  
Vice President & Area Manager  
Middle East & N. Africa  
Treasury Services

Tel. +973 17 522741  
Fax +973 17 535135  
Mobile [REDACTED]

----- Redacted by the Permanent  
Subcommittee on Investigations

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----- Forwarded by David W J BAGLEY/HGHQ/HSBC on 26/05/2006 08:22 -----

David W J BAGLEY/HGHQ/HSBC  
HGHQ  
26/05/2006 08:15  
Phone No. 7991 8645  
+44 (2079) 20 7991 8645  
Mail Size: 16663

To  
Stephen K GREEN/HSBH/HSBCMERIDIAN@HSBC  
cc

Subject

Confidential - FOIA Treatment Requested by HSBC N. America Holdings, Inc. HSB03629426  
Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 3243784

858

Fw: US Dollar Transactional Activities via DDA at JPM  
Entity  
HSBC Holdings plc - HGHQ

Stephen,

I apologise for troubling you on what I know is a busy day.

As discussed I advised HBME DUB to continue to pass U-turn payments through JPMC, and I think quite rightly HBME advised JPMC that we would start to cross-reference the underlying 103 message in the cover message.

As you will note from the attached JPMC have indicated that they are not willing to process these payments, I assume for reputational rather than regulatory reasons (given that they are within the U-turn exemption), which means that we will now have to pass these payments through HBUS. We have previously received concurrence from HBUS, confirmed by Martin. On this basis I do not believe we have any choice but to proceed on this basis.

I would be grateful for your views, but anticipate that HBME will need to reach a decision in time for the opening of the USD payment window on Monday.

David

----- Forwarded by David W J BAGLEY/HGHQ/HSBC on 26/05/2006 07:58 -----

Alan KERR/HBME/HSBC  
HBME  
26/05/2006 06:45  
Phone No. 971 4 5077674  
Mail Size: 7618

To  
Warren G LEAMING/RLA LGA MEM/HBME/HSBC@HSBC, Ian EDEN/HBME/HSBC@HSBC, Ben HOLT/HBME/HSBC@HSBC, David W J BAGLEY/HGHQ/HSBC@HSBC  
cc  
Gary BOON/HBME/HSBC@HSBC, Ken C MATHESON/HBME/HSBC@HSBC  
Subject  
Fw: US Dollar Transactional Activities via DDA at JPM  
Entity  
HSBC Bank Middle East Limited

All,

Please see attached message received from JPMC regarding transactions acceptable for transmission through our USD account with them, which follows on from our discussion with them yesterday morning regarding our imminent move to

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serial payments + cover payments with Field 72 completed.

Please could you provide guidance as to how we may continue to effect OFAC U-turn compliant transactions on behalf of our Iranian customers.

Alan Kerr  
Head of Institutional Banking  
Tel : 971 4 5077 674  
Fax : 971 4 3535079

----- Forwarded by Alan KERR/HBME/HSBC on 05/26/2006 09:37 AM -----

Ali.Moosa@jpmorgan.com  
05/25/2006 09:49 PM  
Mail Size: 5256

To  
Gary BOON/HBME/HSBC@HSBC, Alan KERR/HBME/HSBC@HSBC  
cc  
Layla.Qaseer@jpmorgan.com, Carmel.Speers@jpmorgan.com, colin.j.nutt@jpmorgan.com  
Subject  
US Dollar Transactional Activities via DDA at JPM  
Entity  
HSBC Bank Middle East Limited

Dear Gary,

It was a great pleasure speaking to you and Alan today.

First, many thanks for keeping us informed on the group decision regarding the payments method. This is to confirm that we will be pleased to continue processing HSBC's Middle East dollar payment transactions, (both MT103 and 202) with the exceptions of the Iranian referenced transactions that should be directed to other correspondent banking account. Unfortunately, as a business decision we will not be able to process such Iranian referenced details on the payment narratives.

We look forward to continuing our excellent business relationship. Please do not hesitate to contact us if we can be of any further assistance or if you have any questions.

Have a nice week end.

Ali

Ali Moosa  
Vice President & Area Manager  
Middle East & N. Africa  
Treasury Services

Tel. +973 17 522741  
Fax +973 17 535135

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Mobile [REDACTED]

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From: Rod MOXLEY  
Sent: Tue Jan 02 09:55:48 2007  
To: Andy M NEWMAN  
Subject: Fw: Transactions with Iran / Cuba, etc  
Importance: Normal

Andy

Fyi

I'll let you know if I hear further on this one-an interesting concept, though, let's set up a completely different Swift address to help avoid any problems with Cuba and Iran. Wish I'd thought of it.

Regards

Rod

----- Forwarded by Rod MOXLEY/HBEU/HSBC on 02/01/2007 09:53 -----

Martin S CLARK/HBEU/HSBC 21/12/2006 22:41 To: Rod MOXLEY/HBEU/HSBC@HSBC  
Mail Size: 7704 cc:  
Subject: Fw: Transactions with Iran / Cuba, etc  
Enbly: HSBC Bank plc - HBEU

\*\*\*\*\*  
HSBC Bank plc  
Registered Office: 8 Canada Square, London E14 5HQ  
Registered in England - Number 14259  
Authorised and regulated by the Financial Services Authority  
\*\*\*\*\*

Malcolm G EASTWOOD

From: Malcolm G EASTWOOD  
Sent: 21/12/2006 21:43  
To: Bill E F RICE; Jon H CURRI  
Cc: Vikram BOSE; Douglas MACLENN; Martin S CLARK; Alison J NOOD; John ALLISON;  
James J Y MADSEN; Jim LARGE

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Permanent Subcommittee on Investigations  
**EXHIBIT #62**

HSBC OCC 8876921

Subject: Fw: Transactions with Iran / Cuba, etc

Bill/Jon,

We have heard that this might be coming and here it is !! note that they want to split their traffic - is this possible ?

What are the practical IT and Operational issues with this - ie with GMG going down in the middle of the night fairly regularly could we be taking on a problem we dont need here if Brazil are open when this happens?

I have copied John Allison to see whether Group Compliance have a view given that they are only proposing to send US sanctioned items via this route. I have concerns that we might be breaching at least the spirit of the US Serial Routing GCL if not the letter of it.

Thanks,

Malcolm Eastwood  
Head of Payment and Commercial Operations  
UK Operations  
Tel. 020 798 12300 (798 12300)

----- Forwarded by Malcolm G EASTWOOD@HSBC on 21/12/2006 21:34 -----

Morgane CASAGRANDE@HSBC HBBR  
18/12/2006 14:28 Mail Size: 3196

To

Malcolm G EASTWOOD@HSBC

cc

Cezar JUR@HSBC@HSBC, Eric STRIEGLER@HSBC@HSBC

Subject

Transactions with Iran / Cuba, etc

Entity

HSBC Bank plc - MGBK

Malcolm

Your contact has been provided by Mr Neil Chantry

Appreciate if you could assist us with the following. Not sure anyone has briefed you yet.

HBBR has some payments going into Iran, Cuba and other sanctioned countries, which are compliant with the Group Compliance Policy. Currently our GMG is based in the US, so we run the risk of having such payments blocked. For these specific transactions (circa 50/year), we would like to use the GMG based in the UK and perform the transactions in EUR. To enable it, we have been informed that we have to create a second SWIFT address (BIC ?) to be used exclusively for this purpose, which should also not be published by SWIFT in their books.

Could you assist us with obtaining this second SWIFT address? Any idea how long it would take?

Grateful for any other information you could provide.

I look forward to hearing from you.

Kind regards,

Morgana Casagrande  
Trade & International - HBBR  
Tel: +55 11 3847 9141  
Tel line: 7 227 9141  
Fax: +55 11 3847 5969  
E-mail: morgana.casagrande@hsbc.com.br

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INTENTIONALLY  
LEFT BLANK

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 8876924



From: Rod MOXLEY  
 Sent: Thu Jan 04 17:57:26 2007  
 To: Malcolm G EASTWOOD  
 Subject: Re: Fw: Transactions with Iran / Cuba, etc  
 Importance: Normal  
 Attachments: Doc Link.htm

Malcolm

You and me both.

I do think this requires further investigation before it is "dumped" on us as a fait accompli. Bitter experience, on the part of payments to you and I, have shown that we are faced with a real dilemma when trying to identify and then eventually pay transactions which have so many conditions attached to them. Slightly irritating too that GHQ CMP seem to have bent over backwards to accommodate a system which looks very dodgy to me. How about no you can't do this?

Speak further tomorrow

Regards

Rod

---

Malcolm G EASTWOOD/MDBK/HSBC

Malcolm G EASTWOOD/MDBK/HSBC MDBK  
 04/01/2007 16:38 Phone No : 799 12300  
 +44 (0) 20 7991 2300 Mail Size: 17321

To: Rod MOXLEY/HBEU/HSBC@HSBC  
 cc:  
 Subject: Fw: Transactions with Iran / Cuba, etc  
 From: HSB/C Bank plc - MDBK

Rod,

Just fyi. This all makes me very nervous !

Malcolm Eastwood  
 Head of Payment and Commercial Operations  
 UK Operations  
 Tel: 020 799 12300 (799 12300)

----- Forwarded by Malcolm G EASTWOOD/MDBK/HSBC on 04/01/2007 16:38 -----

**Redacted Material**

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866

Malcolm G EASTWOOD@HSBC MDEK  
04/01/2007 16:37 Phone No 799 12300  
+44 (0) 20 7991 2300 Mail Size: 14217

To: Jim LARGE@HSBC@HSBC  
cc:  
Subject: Fw: Transactions with Iran / Cuba, etc  
Entity: HSBC Bank plc - MDEK

Jim,

I mentioned this one this morning and here is the background. I am doing some more work on it with IT and my people, will then have a confcall with Brazil and give you some input so that we can discuss with Dyfrig.

Malcolm Eastwood  
Head of Payment and Commercial Operations  
UK Operations  
Tel: 020 799 12300 (799 12300)  
----- Forwarded by Malcolm G EASTWOOD@HSBC on 04/01/2007 16:34 -----

John ALLISON@HSBC HQHQ 26/12/2005  
18 11 Phone No. /99 18643  
+44 (0) 20 7991 8643 Mail Size: 11724

To: Malcolm G EASTWOOD@HSBC@HSBC  
cc: Alison J WOOD@HSBC@HSBC, Bill E F RICE@HSBC@HSBC, Douglas MACLEAN@HSBC@HSBC, James J Y MADSEN@HSBC@HSBC, Jim LARGE@HSBC@HSBC, Jon H CURRIE@HSBC@HSBC, Martin S CLARK@HSBC, Vietnam SOSE@HSBC@HSBC, David W J BAGLEY@HSBC@HSBC  
Subject: Re: Fw: Transactions with Iran / Cuba, etc  
Entity: HSBC Holdings plc - HQHQ

Malcolm

Sending payments via USA GMG subjects Brazil to an all currency prohibition for all OFAC entries. Brazil is, however, permitted under current Group policy to make payments in currencies other than USD to entities on the OFAC list, provided that the reason for inclusion on the list is a reason other than Terrorism/Weapons of Mass Destruction (where payments cannot be made in any currency). We believed that this small volume of these permissible payments would be sent by Brazil by "manual" means (telex?).

Whilst we therefore do not have an issue with Brazil's request from a policy point of view, we would be concerned if a second SWIFT address entry drew attention to itself, or contained some reference to this address being used for making payments to entities on the OFAC list, as this could result in a negative perception by those not aware of the detail of our policy.

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Regards

John

Malcolm G.EASTWOOD/MDBK/HSBC

**Malcolm G.EASTWOOD/MDBK/HSBC MDBK** To: Bill E.F.RICE/HBEU/HSBC@HSBC, Jon H.CURL/HBEU/HSBC@HSBC  
 21/12/2006 21:43 Phone No.: 799 12300 cc: Vikram BOSE/HBEU/HSBC@HSBC, Douglas  
 +44 (0) 20 7991 2300 Mail Size: 8019 MACLEAN/HBEU/HSBC@HSBC, Martin S.CLARK@HSBC, Alison J.  
 WOOD/MDBK/HSBC@HSBC, John ALLISON/HQ/HSBC@HSBC,  
 James J.Y.MADSEN/HBEU/HSBC@HSBC, Jim  
 LARGE/HBEU/HSBC@HSBC  
 Subject: Fw: Transactions with Iran / Cuba, etc  
 Entity: HSBC Bank plc - MDBK

Bill/Jon,

We have heard that this might be coming and here it is ! I note that they want to split their traffic - is this possible ?

What are the practical IT and Operational issues with this - ie with GMS going down in the middle of the night fairly regularly could we be taking on a problem we dont need here if Brazil are open when this happens?

I have copied John Allison to see whether Group Compliance have a view given that they are only proposing to send US sanctioned items via this route. I have concerns that we might be breaching at least the spirit of the US Serial Routing GCL if not the letter of it.

Thanks,

Malcolm Eastwood  
 Head of Payment and Commercial Operations  
 UK Operations  
 Tel: 020 799 12300 (799 12300)

--- Forwarded by Malcolm G.EASTWOOD/MDBK/HSBC on 21/12/2006 21:34 ---

Morgana CASAGRANDE/HBBR/HSBC HBBR To: Malcolm G.EASTWOOD/MDBK/HSBC@HSBC

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868

18/12/2006 14:28 Mail Size: 3196

cc: Cezar JR/HBBR/HSBC@HSBC, Eric STRIEGLER/HBBR/HSBC@HSBC  
Subject: Transactions with Iran / Cuba, etc  
Entity: HSBC Bank plc - MD&K

Malcolm

Your contact has been provided by Mr Neil Chantry

Appreciate if you could assist us with the following. Not sure anyone has briefed you yet.

HBBR has some payments going into Iran, Cuba and other sanctioned countries, which are compliant with the Group Compliance Policy. Currently our GMS is based in the US, so we run the risk of having such payments blocked. For these specific transactions ( circa 50 years), we would like to use the GMS based in the UK and perform the transactions in EUR. To enable it, we have been informed that we have to create a second SWIFT address (BIC ?) to be used exclusively for this purpose, which should also not be published by SWIFT in their books.

Could you assist us with obtaining this second SWIFT address? Any idea how long it would take?  
Grateful for any other information you could provide.

I look forward to hearing from you.

Kind regards,

Morgana Casagrande  
Treda & International - HBBR  
Tel: +55 11 3847 9141  
The line: 7 237 5141  
Fax: +55 11 3847 5869  
E-mail: morgana.casagrande@hsbc.com.br

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HSBC Bank plc

Memo

To	Lucas Fmgoso	Date	26 January 2007
CC	Marisa Oliveira Alison Wood Rod Moxley John Allison Jon Curl Bill Rice Jim Large		
From	Malcolm Eastwood	Sender's Reference	
Subject	<b>TRADE TRANSACTION WITH IRAN/CUBA ETC</b>	Receiver's Reference	
To Facsimile No	From Facsimile No. 020 7260 9796	Total No. of pages	

Lucas,

Further to our recent exchange of emails I have now sought views from Group Compliance, IT and my Operations team.

Whilst what you are proposing is technically achievable we are not attracted to a proposal which would segregate certain transactions through separate SWIFT address, albeit that these proposed transactions might be perfectly permissible under Group policy as this might bring unwelcome attention from external parties and at least make it seem as though we are taking action to avoid certain transactions being examined by the US authorities. Group Compliance share this view.

On this basis if we were to make a change I believe that it would have to be on the basis that all of your current SWIFT traffic be directed via the UK GMG. Of course this would be a much more significant challenge for all of us but if it is this route that you wish to pursue please could I ask your team to discuss with Bill Rice (UK Operations) and Jon Curl (UK IT) and Rod Moxley (Risk Management Services, UK Operations and Compliance).

The points I would like covered are

1. Message volumes including averages and peaks so that we can ensure that these volumes are manageable. Whilst the UK GMG is currently meeting our needs IT are currently looking to reshape our GMG infrastructure to ensure better reliability. We must avoid creating further instability.
2. That we can provide viable operational support given the time zone differences between UK and Brazil.
3. WOLF terrorist filtering support, who would undertake this function including case escalation?

Page 1 of 2

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871

Clearly this substantially broadens the scope of our original request, introducing more operational complexity and reputational issues from both the UK and Brazilian banks perspective.

If we are to progress this broader request then I believe that it would be prudent for me to discuss the proposal with the UK Banks CEO before we would formally agree to proceed.

Happy to discuss further with you once you have considered the above.

With kind regards.

Malcolm Eastwood  
Head of Payment and Commercial Operations

Page 2 of 2

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From: David W J BAGLEY  
 Sent: Sat Jun 09 06:38:13 2007  
 To: Michael F GEOGHEGAN  
 Cc: Stephen K GREEN; David H HODGKINSON; Douglas FLINT  
 Subject: Re: Iran  
 Importance: Normal

Mike,

I should briefly clarify that there is very little left of our relationship with [REDACTED] although enough to mean that it would have been inaccurate to tell Levey there was nothing [REDACTED]

Without being able to look back over previous correspondence on this issue my recollection of key recent decisions on Iranian banks include

1. We decided some time ago to stop using the U-turn exemption under OFAC.
2. We cancelled trade lines previously extended to certain Iranian banks including [REDACTED] and these have virtually run off in the case of [REDACTED]
3. We discovered that there was an agency banking relationship in HBEU both for [REDACTED] and other Iranian banks. Notice has been given on these and we have made it clear that these must be closed by end July [REDACTED]

There are further complications surrounding the process of closure with all Iranian banks as we have some USD 9m in reimbursements due from Sepah, where we are running off trade lines, where we may need co-operation from Central Bank of Iran. David is in the loop here.

I am in fact travelling next week but will monitor by BlackBerry. Apologies for the length of the e-mail but I thought the above detail may help deliberations next week

David

HSBC Holdings plc  
 Registered Office: 8 Canada Square, London E14 5HQ, United Kingdom  
 Registered Number 617987

Michael F GEOGHEGAN

From: Michael F GEOGHEGAN  
 Sent: 08/06/2007 20:30 GMT  
 To: David W J BAGLEY  
 Cc: Stephen GREEN; David H HODGKINSON; Douglas FLINT

Permanent Subcommittee on Investigations  
 EXHIBIT #63

Redacted Material  
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HSBC OCC 8878214



Subject: Re: Iran

David

This is not clear to me because some time ago I said to close this relationship other than for previously contractually committed export finance commitments

Possibly we can discuss this next week when I will be able to review my past emails

Mike

\*\*\*\*\*  
 HSBC Holdings plc  
 Registered Office: 8 Canada Square, London E14 5HQ, United Kingdom  
 Registered Number 617987  
 \*\*\*\*\*

David W J BAGLEY

From: David W J BAGLEY  
 Sent: 08/06/2007 09:17 GMT  
 To: Michael F GEORGEAN  
 Co: Stephen GREEN; David H HODGKINSON; Douglas FLINT  
 Subject: Iran

Mike,

Stuart Levey, the US Treasury Under Secretary for Counter Terrorist Financing and Sanctions was a speaker at the recent annual conference of the Wolfsberg Group, of which I currently act as Co-chair. Levey asked for a private meeting with me to discuss a number of matters including Iran. Levey has been extremely active in promoting the US policy on Iran, particularly the use of sanctions to deter weapons proliferation. He has in the past met with David and I to encourage us to refrain from dealings with Iranian banks. The key points raised with me, and the subsequent actions agreed with David are best summarised as follows:

Levey acknowledged that we as a Group have acted responsibly on Iran and I took the opportunity to emphasise to him that we applied OFAC across the Group when dealing in USD, and had acted whenever specific sanctions were enacted either by US, UK or UN.

Levey however expressed concern that we were still operating accounts for [REDACTED] who he asserted had clearly been identified as having acted as a conduit for Iranian governmental funding of [REDACTED]

[REDACTED] this is a repeat of allegations made previously by the US which have led to targeted sanctions in the US, but have not had support within the UN. Levey essentially threatened that if HSBC did not withdraw from relationships with [REDACTED] we may well make ourselves a target for action in the US. It appears that we have been approached in this way as he

Redacted Material

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HSBC OCC 8878215

alleges that [REDACTED] use the fact that we have maintained accounts for them as an argument in support of representations made to other banks for ongoing support.  
We in fact have only limited relationships, with [REDACTED] and in fact overall with Iranian banks.  
Following this meeting I have discussed the approach we should take with David. His decision is that we should immediately withdraw from [REDACTED] and also withdraw from all Iranian bank relationships in a co-ordinated manner, recognising that there may be some legally binding commitments we will have to honour (for example PEF facilities), and we may need to allow for an orderly run-off.  
Once the position is clear on precisely what steps are being taken I will then advise Levey of the steps we have taken.

I am aware that Levey has sought to persuade other non-US banks to withdraw from Iran, but the tone of his remarks were notably more direct and strident.

David Bagley

Redacted Material

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HSBC OCC 8878216

From: John ALLISON  
 Sent: Wed Jun 13 11:36:00 2007  
 To: Clive BISSETT  
 Subject: Fw: GROUP MESSAGING GATEWAY FOR LAM - CLEAR CHOICE REPORT  
 Importance: Normal  
 Attachments: Doc Link.htm

Clive

Any thoughts on how to deal with these countries?

Regards

John

----- Forwarded by John ALLISON/HGHQ/HSBC on 13/06/2007 11:35 -----

<b>Neelesh HEREDIA/HBMX/HSBC HBMX</b> 11/06/2007 16:02 Mail Size: 26167	To: John ALLISON/HGHQ/HSBC@HSBC cc: Clive BISSETT/HBEU/HSBC@HSBC, Tomas.davidovich@hsbc.com.mx, Jon H. CURL/HBEU/HSBC@HSBC Subject: Fw: GROUP MESSAGING GATEWAY FOR LAM - CLEAR CHOICE REPORT Entity: HSBC Holdings plc - HGHQ
--	--

John,

We have not engaged with CI and Nassau as we have no leadership responsibility for this geography. I trust they will deal direct with IT, PCM, et al and look after themselves.

Regards,

----- Forwarded by Neelesh HEREDIA/HBMX/HSBC on 11/06/2007 09:58 a.m. -----

<b>Sandy Flockhart/HBMX/HSBC</b> 01/06/2007 06:34 p.m.	To: Neelesh HEREDIA/HBMX/HSBC@HSBC cc: Alan BEATTIE/HBAR/HSBC@HSBC, Antonio M. LOSADA/HBAR/HSBC@HSBC, Arturo RIVERA/HBMX/HSBC@HSBC, Clive BISSETT/HBEU/HSBC@HSBC, David W J. BAGLEY/HGHQ/HSBC@HSBC, Eduardo Palacios, Kahuam/HBMX/HSBC@HSBC, Emilson ALONSO/HBBR/HSBC@HSBC, Gary M. PHILLIPS/HBMX/HSBC@HSBC, Graham MACNAUGHTON/HBMX/HSBC@HSBC, Jae PARKA/HBBR/HSBC@HSBC, John ALLISON/HGHQ/HSBC@HSBC, John R. RENDALL/HBMX/HSBC@HSBC, Jon H. CURL/HBEU/HSBC@HSBC, Luis
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HSBC OCC 8874349

876

EDUARDO/HBBR/HSBC@HSBC, Luis M  
MARTINEZ/HBAR/HSBC@HSBC, Luiz  
SIMONE/HBBR/HSBC@HSBC, Marian  
JEFFERY/HBEU/HSBC@HSBC, Paul A  
THURSTON/HBMX/HSBC@HSBC, Ramon  
GARCIA/HBMX/HSBC@HSBC, Tomas  
DAVIDOVICH/HBMX/HSBC@HSBC

Subject: Re: GROUP MESSAGING GATEWAY FOR LAM - CLEAR  
Choice Report

Neelesh,

As this is the most cost effective solution you have my approval to proceed as proposed.

Regards,

Sandy

Alexander A. Flockhart  
President & Group Managing Director  
Latin America and the Caribbean  
Paseo de la Reforma 347  
Oficina 23 Piso 32  
Col. Cuauhtemoc  
06500 Mexico, D.F.  
Tel: 52-55-5721-3914

Neelesh HEREDIA/HBMX/HSBC

Neelesh HEREDIA/HBMX/HSBC 05/31/2007  
05:59 PM

To: Sandy Flockhart, Gary M PHILLIPS/HBMX/HSBC@HSBC,  
Eduardo Palacios Kahum/HBMX/HSBC@HSBC, David W J  
BAGLEY/HGHQ/HSBC@HSBC, Ramon Garcia, Jon  
PARK/HBBR/HSBC@HSBC, Graham Macnaughton, Luis  
EDUARDO/HBBR/HSBC@HSBC, Alan  
BEATTIE/HBAR/HSBC@HSBC, John R  
RENDALL/HBMX/HSBC@HSBC  
cc: Paul A THURSTON/HBMX/HSBC@HSBC, Emilson  
ALONSO/HBBR/HSBC@HSBC, Antonio M  
LOSADA/HBAR/HSBC@HSBC, Tomas  
DAVIDOVICH/HBMX/HSBC@HSBC, Clive  
BISSETT/HBEU/HSBC@HSBC, John  
ALLISON/HGHQ/HSBC@HSBC, Jon H  
CURRIE/HBEU/HSBC@HSBC, Marian  
JEFFERY/HBEU/HSBC@HSBC, Arturo  
RIVERA/HBMX/HSBC@HSBC, Luis M

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HSBC OCC 8874350

877

MARTINEZ/HBAR/HSBC@HSBC, Luz  
SIMIONE/HBBR/HSBC@HSBC  
Subject: GROUP MESSAGING GATEWAY FOR LAM - CLEAR CHOICE  
Report

AE,

As you are aware, we have been assessing the most viable and Group policy compliant Group Messaging Gateway (GMG) for future processing of LAM payments. Attached is the final version of the Clear Choice (CC) and to which I request your approval to proceed.

For ease of reference, I advise that the CC report recommends migration of all LAM non US Based SWIFT addresses to the UKGMG.

The CC was collectively put together by: IT, PCM and CMP in the UK and IT, CMP, PCM in LAM, representatives from HBBR, HBAR and OPSCO (for HBMX, LAM International and CC sponsorship). My thanks to all participants.

Post approval, priority next steps include:

Definition of: Project sponsor, Project Coordinators for LAM and the UK from Business and IT, In-country Business and IT representation and supporting LAM and UK Project teams. Action: Davidovich.  
Preparation and approval of a Project Terms of Reference. Action: Project Coordinators in LAM and UK.  
Advice to all LAM countries of CC decision. Action: Heredia.  
Progress with HBEU IT the need for spanish speaking support during LAM's working hours at the SYDGC. Action: Heredia with Phillips.  
Identify and agree Pilot site. Action: Heredia with Macnaughton.

Follow on actions will include: prioritised list of countries to be migrated, roll-out plan and timelines, project plans per country, SLAs between countries and the SYDGC, formalisation of the migration of Keys and Access rights, demise of SWIFT Alliance etc.

Please address any queries arising to me.

Regards,

Neelesh

[attachment "Clear Choice - Non US SWIFT Address GMG Migration - FINAL.doc" deleted by Neelesh HEREDIA/HBMX/HSBC]

David,

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HSBC OCC 8874351

The contact should be Neelesh Heredia but Graham Macnaughton Head of International and Eduardo Palacios Head of PCM should be copied in all correspondence.

Regards,

Sandy

Alexander A. Flockhart  
President & Group Managing Director  
Latin America and the Caribbean  
Paseo de la Reforma 347  
Oficina 23 Piso 32  
Col. Cuauhtemoc  
06500 Mexico, D.F.  
Tel: 52-55-5721-3914

David W J BAGLEY/HQHQ/HSBC

David W J BAGLEY/HQHQ/HSBC Sent by: To: Sandy Flockhart/HBMX/HSBC@HSBC  
Marion O ROACH 22/03/2007 11:11 a.m.  
cc  
Subject: GROUP MESSAGING  
ct

Sandy

I refer to your e-mail of 14th March.

Clive Bissett, Global Project Manager, GTB has been nominated to assist with the preparation of a Clear Choices document. Could I suggest therefore that someone be nominated for LATM to liaise closely with Clive which will ensure that a proper and complete consideration will be given, including to the capacity issues.

I am aware from my contact with CMP in Brazil that they were giving some consideration to giving up certain payments activity given the challenges of passing that activity through the US. We have indicated that any final decision should be deferred in this regard pending a proper consideration as to whether the payments messaging can be migrated elsewhere thus allowing us to preserve as much activity and business as possible. There may also need to be a conversation at some stage with Paul Lawrence if it is necessary to persuade HBUS to continue with payment messaging pending any migration. I will however advise further if this proves to be the case.

At my end I will ask one of my team, John Allison, to support Clive. I look forward to receiving details of your nominated contact whereupon I will ask Clive to make appropriate contact and commence the necessary work.

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HSBC OCC 8874352

I am grateful for your assistance.

Regards

David Bagley

---

Sandy Flockhart

----- Original Message -----

**From:** Sandy Flockhart  
**Sent:** 03/14/2007 12:45 PM  
**To:** David W J BAGLEY  
**Cc:** David Leighton; Neelash HEREDIA; Paul A THURSTON; Graham MACNAUGHTON  
**Subject:** Re: Group Messaging

David,

We are similarly keen to ensure that payments continue to operate smoothly, whilst being completely compliant with Group requirements, and to this end would not be averse in principle to re-routing payments traffic via Sheffield, rather than as present, via the USA.

Whilst clearly this would need to be fully evaluated, not least in respect of the cost savings that would presumably accrue, as well as the ability to meet specific Latin American requirements (time zone, language etc), we would want to ensure that all Latin American countries met the most stringent requirements, possibly by centralising all payments through a Payments Services Centre such as the one we recently commissioned in Mexico. One component of this might be to ensure that we used precisely the same algorithms and screening parameters as are used by the US, but this too would be part of the abovementioned evaluation.

Clearly a decision will need to be taken soon as we are in the process of defining the migration of Banistmo, which, until your communication was received were going to be routinely routed through the United States in the usual way. However, you mention there may be capacity issues in the UK, and of course these would need to be resolved without disproportionate cost implications for LATAM. It would therefore be helpful if you would advise the name of a contact with whom we could discuss various points of detail prior to reaching a final decision, and with who we could work with afterwards to convert if such was decided to be the way forward.

I look forward to receiving your thoughts on the above.

Regards,

Sandy

Alexander A. Flockhart

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HSBC OCC 8874353

President & Group Managing Director  
 Latin America and the Caribbean  
 Paseo de la Reforma 347  
 Oficina 23 Piso 32  
 Col. Cuauhtémoc  
 06500 México, D.F.  
 Tel: 52-55-5721-3914

David W J BAGLEY/HGHO/HSBC

David W J BAGLEY/HGHO/HSBC Sent by: To: Sandy Flockhart/HBMXA/HSBC  
 Marion O ROACH 13/03/2007 09:08 a.m. cc:  
 Subject: Group Messaging  
 ct

Sandy

With apologies for the length of the note set out below, I need to raise an issue with you which relates to payment messaging for large, if not all, parts of Latin America. This is an issue that has been around for some time, but probably now needs a strategic high-level decision given the potential, commercial and cost consequences. The key issues are as follows:-

You will of course be aware of the increased significance of compliance with the US sanctions promulgated by OFAC. This has led to the Group reinforcing and reiterating a requirement for all Group offices to comply with OFAC in relation to transactions denominated in USD regardless of their place of incorporation or operation. This policy is well-established, and appears to be adhered to very closely by Group companies.

Obviously our operations in the US are obliged to comply with the requirements of OFAC in all currencies, not just USD. This obviously reflects the fact of either their US incorporation, or the fact that they were operating within the US. Within the US however there is an increased focus upon effective compliance with the requirements OFAC on the part of both OFAC itself but also our banking regulators.

At present, cross-border payments, regardless of currency, initiated by most, if not all of our operations in Latin America pass through the payment gateway operated by HBUS in the US. The increased focus upon OFAC compliance has led us to consider various situations where transactions pass through the US, but are not initiated by and do not involve our Group companies in the US. They are, in effect, merely a service provider.

This also applies to certain of our subsidiaries where payment processing is initiated in the US but all parts of the transaction are processed in the US. This is a situation which is not covered by the US requirements.

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HSBC OCC 8874354



This clearly has the potential for adverse commercial consequences, in that transactions in currencies other than USD involving countries or entities covered by US sanctions would be caught even though overall they were permitted by Group policy by reason of their non-USD denomination. For this reason, we are in the process of relocating the .net and .com services, and made a conscious decision to develop a stand-alone WHIRL system server in the UK where the original proposal was to host all Group credit card transactions through servers located in the US.

Obviously the significance of the above is that where payments are processed through the New York gateway on behalf of Latin American operations then HBUS, taking a cautious approach justified by the current regulatory environment, will need to filter all transactions regardless of currency and reject those transactions where they would breach OFAC regardless of currency. This would clearly be disadvantageous from Latin America's perspective, and equally I suspect the logistics of having to locally pre-screen all cross-border payments in all currencies would be commercially and operationally challenging for our operations in Latin America.

My own view is that commercially you would find the introduction of filtering by our US colleagues unattractive commercially, and I do remember the problems that a local US hotel chain got into when refusing access to certain Cuban visitors. If my assumption here is correct then on the assumption that you will want to carry out as many transactions permitted by Group policy as possible the most viable option and way forward would seem to be to relocate your payment processing to a different Group Messaging (GMG) gateway. This however would need your support and the generation of an appropriate business case and clear choices proposal. Any such proposal would need to take account of likely impacts upon operational support, time zones, performance and cost. We have informally explored the possibility of relocating Latin American flows to the UK GMG, but this centre has experienced some capacity issues.

Whilst we have lived with the current position for some time, it is fair to say that now that our US colleagues are on notice they feel extremely uncomfortable in allowing the position to continue indefinitely. In essence, we will either have to have a pass and timeline for a relocation of the payment messages or will need to turn the filtering on.

I thought it important to canvas this issue with you first, but recognise that you will probably want to nominate one of your team to take matters forward. Similarly, we will provide as much assistance as we can here in GHQ CMP, having developed some understanding and knowledge of the issues posed by OFAC, and possible solutions and approaches to resolve those challenges.

Regards

David Bagley

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OCC-PSI-0089823

HSBC-OCC\_E 0599421.txt  
 From: ANNE LIDDY/HBUS/HSBC  
 Sent: 6/19/2008 11:54:26 AM  
 To: NANCY HEDGES/HBUS/HSBC@HSBC02  
 CC:  
 Subject: Re: OFAC processing in GSC's

ok, thanks Nancy. We are all feeling the pressure re not hiring onshore - only off. Keep me posted.

Anne Liddy  
 SVP, AML Compliance | HSBC Bank USA, N.A.  
 452 5th Avenue, Tower 7, New York, NY 10018

Phone 212-525-5906  
 Fax 212 525 5769  
 Email anne.liddy@us.hsbc.com

Nancy Hedges/HBUS/HSBC  
 06/19/2008 12:20 PM

To  
 Anne Liddy/HBUS/HSBC@HSBC02  
 CC  
 Subject  
 Re: OFAC processing in GSC's

fyi - I have put forth the suggestion of hiring up some first level checkers for OFAC processing in the GSC... we're strapped and getting behind in investigations (on OFAC cases) and have some of our key managers in the queues releasing items... I'm told I cannot hire first level staff unless it's offshored... so.... here we go! Have asked for the greenlight to commence further discussions with Compliance and will set something up with you when I get it.

Anne Liddy/HBUS/HSBC  
 05/30/2008 08:54 AM

To  
 Nancy Hedges/HBUS/HSBC@HSBC02  
 CC  
 Subject  
 Re: OFAC processing in GSC's

Page 1

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Permanent Subcommittee on Investigations  
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HSB02545484

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HSBC OCC 0616349

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OCC-PSI-0089823

HSBC-OCC\_E 0599421.txt

Nancy, currently we have offshore resources conducting first level reviews of customer hits with oversight and QC conducted by ICRO. We have emphasized to our regulators when offshoring is discussed (they get very nervous on this topic with respect to AML and OFAC) that the risk is lower in offshoring first level customer hit reviews vs payment hit reviews. The customers have already been vetted. We would really have to talk this one through internally and then potentially let the regulators know if the Bank decided to move forward on this - just my thoughts. I reached out to Denise on this as well and she agrees.

Anne Liddy  
SVP, AML Compliance | HSBC Bank USA, N.A.  
452 5th Avenue, Tower 7, New York, NY 10018

Phone 212-525-5906  
Fax 212 525 5769  
Email anne.liddy@us.hsbc.com

Nancy Hedges/HBUS/HSBC  
05/29/2008 12:37 PM

To  
Anne Liddy/HBUS/HSBC@HSAC02  
cc

Subject  
OFAC processing in GSC's

Any issue that you know of with processing our OFAC hits out of one of the GSC's? The only thing I think there may be an issue with is how the Fed might view it and the fact that personal fines / incarceration of staff could occur (hopefully never here) and how would that be handled / looked at if the staff are in India / Malaysia?

Nancy Hedges  
Sr PCM Dept Ops Mgr | HSBC Bank USA  
90 Christiana Road, New Castle, DE

Phone. 302-327-2333  
Fax 302-327-2363  
Mobile. 302-438-0336  
Email nancy.hedges@us.hsbc.com

Page 2

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From: MICHAEL B GALLAGHER/HBUS/HSBC  
 Sent: 12/11/2009 2:38:40 PM  
 To: CHRIS P DAVIES/HBUS/HSBC@HSBC  
 CC: LESLEY MIDZAIN/HBUS/HSBC@HSBC02  
 Subject: FW: OFAC Payments

This is concerning.

Michael B. Gallagher  
 Executive Vice President  
 Global Transaction Banking  
 452 5th Avenue  
 New York, NY 10018  
 Tel: 212-525-5680

----- Forwarded by Michael B Gallagher/HBUS/HSBC on 12/11/2009 02:38 PM -----

From: Camillus P Hughes/HBUS/HSBC  
 To: Sandra Peterson/HBUS/HSBC@HSBC02  
 CC: Charles G DelBusto/HBUS/HSBC@HSBC02, Michael B Gallagher/HBUS/HSBC@HSBC02,  
 "Thomas W Halpin" <thomas.w.halpin@us.hsbc.com>  
 Date: 12/11/2009 02:28 PM  
 Subject: Re: FW: OFAC Payments

Sandra,

We have considered all options at this point the Compliance team in DE is already fully deployed dealing with wire camp alerts and bank examiner requests for the current exam. There is no bandwidth there at all they are behind on the current alert clearing process which we are also working on dealing with.

Thanks and regards,

Camillus P Hughes  
 Grp Dir-Specialized Compl II | HSBC Bank USA  
 452 Fifth Avenue

Phone. 212-525-8607  
 Fax. 212-382-5961  
 Email. camillus.p.hughes@hsbcpb.com

From: Sandra Peterson/HBUS/HSBC  
 To: Michael B Gallagher/HBUS/HSBC@HSBC02  
 CC: "Camillus Hughes" <camillus.p.hughes@hsbcpb.com>, Charles G DelBusto/HBUS/HSBC@HSBC02, "Thomas W Halpin" <thomas.w.halpin@us.hsbc.com>  
 Date: 12/11/2009 01:21 PM  
 Subject: Re: FW: OFAC Payments

Michael,

We have been providing headcount to the operations team here in Delaware as follows:

Nov. 24th --->Nov. 27th  
 Stephanie Brown  
 Denise Richards  
 Francisco Fernandez

Page 1

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Permanent Subcommittee on Investigations  
**EXHIBIT #66**

ic. HSB00160335  
 HSBC OCC 7688668

885

HSBC-OCC\_E 0041342.txt

Nov. 30----->Dec. 4th.  
Francisco Fernandez

Dec. 11th  
The above individuals to assist on addressing the investigation OFAC queue today.

Trying to manage our day to day and assist as best we can. I do not have other resources to give at this point, but will double check with ops to see if resources can be shifted.

cam, have we tapped the compliance team here in Delaware?

Best regards,

Sandra Peterson, SVP, Global Payments and Cash Management  
Regional Head Client Management, Americas | HSBC Bank USA  
90 Christiana Road  
New Castle, DE 19720

Phone. 302-327-2220  
Fax. 302-327-2128  
Email. sandra.peterson@us.hsbc.com

Michael B Gallagher/HBUS/HSBC  
12/11/2009 10:01 AM

To: Charles G DeBusto/HBUS/HSBC, "Thomas W Halpin"  
<thomas.w.halpin@us.hsbc.com>,  
"Sandra Peterson" <Sandra.Peterson@us.hsbc.com>  
Cc: "Camillus Hughes" <camillus.p.hughes@hsbcpb.com>  
Subject: FW: OFAC Payments

Do we have some bodies we can lend. This backlog is concerning and it is in our collective interest to get this cleaned up.

cam - is this a blip or do we have a new staffing requirement?

----- Original Message -----  
From: Camillus P Hughes  
Sent: 12/11/2009 09:44 AM EST  
To: Michael Gallagher  
Subject: OFAC Payments  
Michael,

Page 2

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HSBC-OCC\_E 0041342.txt

Spoke with our OFAC team, we could use 5 or 6 people for 10 days who can review payments to clear the 700 and building backlog of payments that have been held over and need to be worked to process.

Skillset is fairly straight forward. They would need to understand how to read a wire and be able to review the information provided by the client against payment information to determine if the item is a false positive and can be processed. We have all of the materials printed for review and can set this up as an assembly line.

You can reach me on 212-525-8607.

Thanks and regards,

Camillus P Hughes  
Grp Dir-Specialized Comp1 II | HSBC Bank USA  
452 Fifth Avenue

---

Phone. 212-525-8607  
Fax. 212 382-5961  
Email. camillus.p.hughes@hsbcpb.com

---

From: David W J BAGLEY  
 Sent: Sun Aug 22 20:20:52 2010  
 To: Warren G LEAMING  
 Subject: Fw: Project Topaz US Urgent Requirements  
 Importance: Normal

Warren

Result of the push.

Regards

\*\*\*\*\*

HSBC Holdings plc  
 Registered Office: 8 Canada Square, London E14 5HQ, United Kingdom  
 Registered in England number 617987

\*\*\*\*\*

From: Andrew P LONG  
 Sent: 22/08/2010 18:51 GDT  
 To: Irene M DORNER/HBUS/HSBC@HSBC02  
 Cc: David W J BAGLEY; Michael B Gallagher/HBUS/HSBC@HSBC02; Niall S K Booker/HBUS/HSBC@HSBC02;  
 Nicholas J TAYLOR/HBUS/HSBC@HSBC02  
 Subject: Re: Project Topaz US Urgent Requirements

Irene

I will work with the rest of Group as requested.

Because the relationships are not actually owned by FIG, being orphans, I have sent the note to Heads of International in the regions to forewarn them and I expect to hear by tomorrow from them. I will try and push this through in the next 48 hours.

Andrew

Andrew P LONG  
 Group General Manager & Head of Global Transaction Banking, HSBC Holdings plc  
 Level 28, 8 Canada Square, London E14 5HQ, United Kingdom

Phone: (44) (0) 20 7991 2100 Internal: 799 12100  
 Email: [andrew.long@hsbc.com](mailto:andrew.long@hsbc.com)

<https://relativity/Relativity.Distributed/Download.aspx?ArtifactID=4760279&GUID=407...> 11/01/2012

Permanent Subcommittee on Investigations

EXHIBIT #67

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HSBC OCC 8876104

Irene M  
DORNER@HBS/HSBC@HSBC02 To  
Aug 20 2010 22:16 Mail Size: cc  
275155 Subject

"Andrew LONG" <andrewlong@hsbc.com>  
Nat S K Books@HBS/HSBC, Nicholas J TAYLOR@HBS/HSBC@HSBC  
Gallagher@HBS/HSBC@HSBC02  
Project Topaz US Urgent Requirements

Andrew

Following the Topaz meeting, I explained that the US would need some immediate assistance and probably an interim solution as we cannot wait for the outcome of a complex and prolonged project. We need to move quickly to reduce the AML alerts and the connected KYC issues as it is impossible to plan the required capacity unless we do and in addition, we need to show progress to our Regulator.

We have completed Phase 1 of a review of international banks and countries and HBS must now move quickly to withdraw from those which do not meet either risk or return hurdles. We cannot get sufficient traction across the HSBC world to exit these names in a timely fashion. We have consulted widely and achieved broad consensus from Product and Global banking but inevitably, for some, there are still pockets of dissent, usually from regional/in-country teams.

Attached is a list of 121 international banks that we can no longer support and need to exit. For each it shows the country of origin, the country of parentage, the reason for exit and the direct revenue implications. The total revenue estimate for these banks is USD18.1m (although for a small number of primarily high risk exits this data is not immediately available). However, you will note that of this total Angola accounts for over USD15m and Sierra Leone and Belarus together close to another USD1m.

The rationale for exit will be one of two broad categories:

1. Where an independent review by FEDD has determined the credit or reputational risk is too high, or
2. Where rationalisation on the basis of commerciality is recommended following a country by country Panel review comprising Global Banking, TSC and PCM.

This is being managed and coordinated centrally by HBS FIG but where there is no GRM, PCM Executives will be required to write to the clients. It is not viable for the CEO of HBS to ask for closure of an account in another country and so, similar to Barron, I would be grateful for your help in getting prompt cooperation in the exit process.

In the absence of a compelling business case for retention, we need to start exiting these relationships next week. We cannot afford the time to negotiate each name, so rather than HBS asking for a closure, waiting for the pushback and getting into multiple debates, I propose that we view the situation differently and we tell you which names we can no longer support and set timelines for the exits which need to be accomplished in the relevant geographies. For high risk clients we will give 30 days notice of termination end for all others 60 days. I am happy to discuss how we go about this but I believe that the communication of the names to be exited and the timelines needs to come from GMD.

Just to keep you in the loop, Phase 1 focuses on USD PCM only but will be followed rapidly by Phase 2 as you will appreciate the urgency with which we need to resolve our regulatory issues related to KYC and AML alerts. In Phase 2 there will be Trade names the exit for which may be more complicated but to give you a flavour of the problem, we seem to have 16 correspondent banks in Sudan which cannot be right. From our analysis of the situation aside from risk, it is clear that the sheer volume of clients we have contributes to the current problems. Phase 2 of our review will therefore concentrate on revenue and for HBS PCM alone, it appears that

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HSBC OCC 8876105



approximately 1,200 names collectively earn less than USD4.5m per year. This is an average revenue of less than USD3,600 each, which in many instances, does not cover our ongoing compliance costs. Whilst some of these are propositional, for high risk countries and high alert generators, we will propose a material further rationalization shortly. We will need your help here too.

Clearly, the US requirements cut across business lines and it is crucial that the strategies of PCM, TSC and FIG are aligned to prevent this situation occurring in the future.

Regards

Irene

**Irene M Dorner**

President & CEO, HUSI & HBUS  
HSBC Bank USA  
452 Fifth Avenue | 10th Floor | New York, NY 10018

Phone.	212-525-4359
Fax.	212-525-8213
Email.	<a href="mailto:irene.m.dorner@us.hsbc.com">irene.m.dorner@us.hsbc.com</a>

[attachment "08-20 HBUS PCM Exits.xls.zip" deleted by Andrew P LONG/IBEU/HSBC]

\*\*\*\*\*  
HSBC Bank plc may be solicited in the course of its placement efforts for a new issue, by investment clients of the firm for whom the Bank as a firm already provides other services. It may equally decide to allocate to its own proprietary book or with an associate of HSBC Group. This represents a potential conflict of interest. HSBC Bank plc has internal arrangements designed to ensure that the firm would give unbiased and full advice to the corporate finance client about the valuation and pricing of the offering as well as internal systems, controls and procedures to identify and manage conflicts of interest.

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HSBC OCC 8876106

## EXCERPT

### RESULTS OF THE TRANSACTIONS REVIEW – UK GATEWAY

March 29 2012

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This document should be read in conjunction with the explanatory notes on page 71.

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Permanent Subcommittee on Investigations  
EXHIBIT #68

HSBC, Inc. HSB09340592  
HSBC-PSI-PROD-0197919

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Confidential Treatment Requested HSBC-PSI-PROD-0197930

CONSOLIDATED RESULTS – TRANSACTIONS SENT VIA THE US PER SANCTIONS REGIME

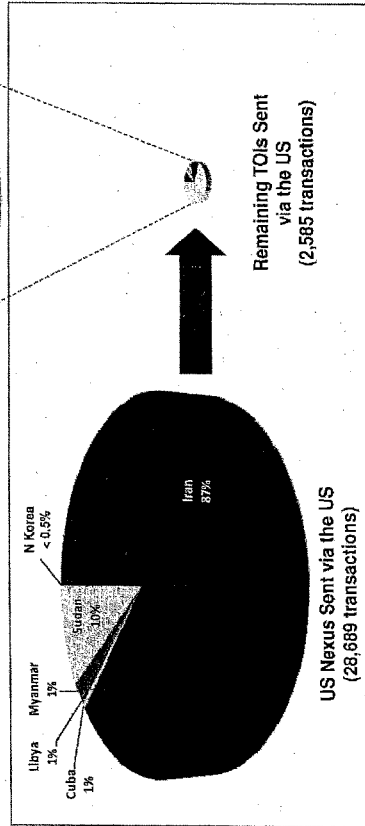
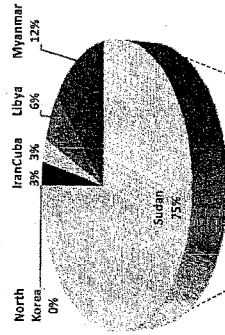
Reporting Category	Iran	Cuba	Libya	Myanmar	North Korea	Sudan	Total
	Value \$'000 (Volume)	Value \$'000 (Volume)	Value \$'000 (Volume)	Value \$'000 (Volume)	Value \$'000 (Volume)	Value \$'000 (Volume)	Value \$'000 (Volume)
1. Identified US Nexus transactions	19,422,415 (24,987)	53,932 (151)	21,836 (226)	110,231 (435)	502 (8)	188,546 (2,882)	19,787,462 (28,689)
2. Permissible Transactions	19,232,256 (24,651)	11,527 (45)	420 (34)	293 (52)	502 (8)	28,478 (608)	19,273,476 (25,398)
A. Iranian U-turn transactions	18,950,651 (24,171)	- (-)	- (-)	- (-)	- (-)	- (-)	18,950,652 (24,171)
B. OFAC license or other exemption	271,252 (402)	11,475 (30)	420 (34)	139 (41)	502 (8)	25,335 (541)	309,123 (1,056)
C. Blocked, rejected or cancelled	10,353 (78)	52 (15)	- (-)	154 (11)	- (-)	3,143 (67)	13,702 (171)
3. Transactions of Interest	190,159 (336)	42,404 (106)	21,416 (192)	109,938 (383)	- (-)	160,068 (2,274)	523,986 (3,291)
4. Potentially licensable	145,052 (257)	109 (29)	1,555 (29)	1,879 (51)	- (-)	7,991 (340)	156,586 (706)
5. Remaining Transactions of Interest	45,107 (79)	42,295 (77)	19,861 (163)	108,059 (332)	- (-)	152,077 (1,934)	367,400 (2,585)

No transactions sent via the US were identified as being subject to Syrian or Iraqi sanctions. The Iran results include two transactions relating to charges of \$15 each, that were processed from the correspondent accounts of two Iranian banks after they were designated as SDNs.  
The total number of transactions set out above is higher than the total listed on Slide 10, as there are a small number of transactions which relate to more than one sanctions regime. These have been included in all applicable sanctions regimes in the table above.

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March 29 2012 12

CONSOLIDATED RESULTS – US NEXUS AND TOIs SENT VIA THE US BY VOLUME



March 29, 2012 13

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Confidential Treatment Requested HSBC-PSI-PRDD-0197931

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Confidential Treatment Requested HSBC-PSI-PROD-0197940

CORRESPONDENT ACCOUNTS BY SANCTIONS REGIME

The table below summarises the number of all USD accounts and non-USD accounts, with USD transaction activity, by the location of the account and the related sanctions regime.

Sanctions regime	UK		Dubai		Total	
	USD a/cs – USD transactions identified	Non-USD a/cs USD transactions identified	USD a/cs – USD transactions identified	Non-USD a/cs – USD transactions identified	USD a/cs – USD transactions identified	Non-USD a/cs – USD transactions identified
Cuba	6	6	0	0	6	6
Iran	11	11	8	2	19	13
North Korea	2	0	0	0	2	0
Sudan	18	13	0	0	18	13
Syria	1	1	0	0	1	1
Total	38	31	8	2	46	33

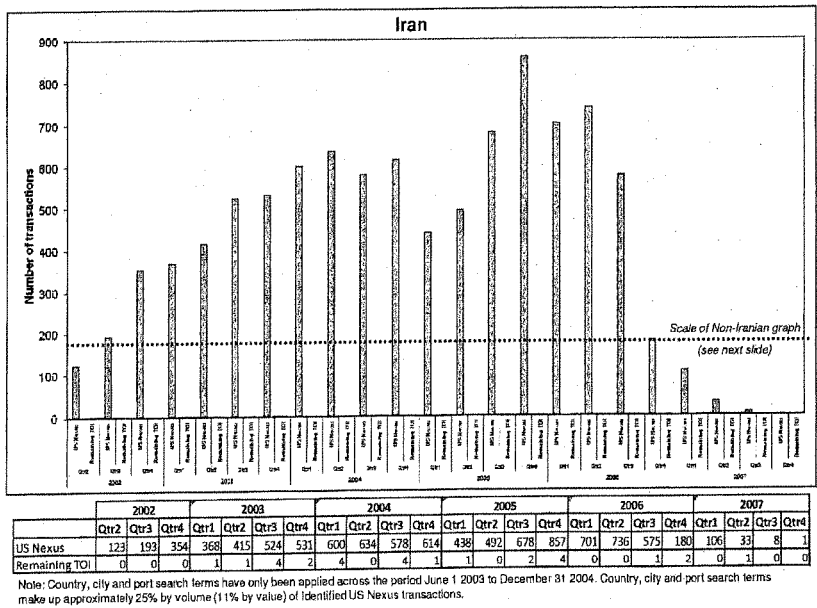
There are four additional accounts held by the Bank in another jurisdiction, subject to the Sudanese sanctions regime, which are not included in the table above. The names of these accounts cannot currently be disclosed, however the SWIFT transactions relating to these accounts are included within this document.

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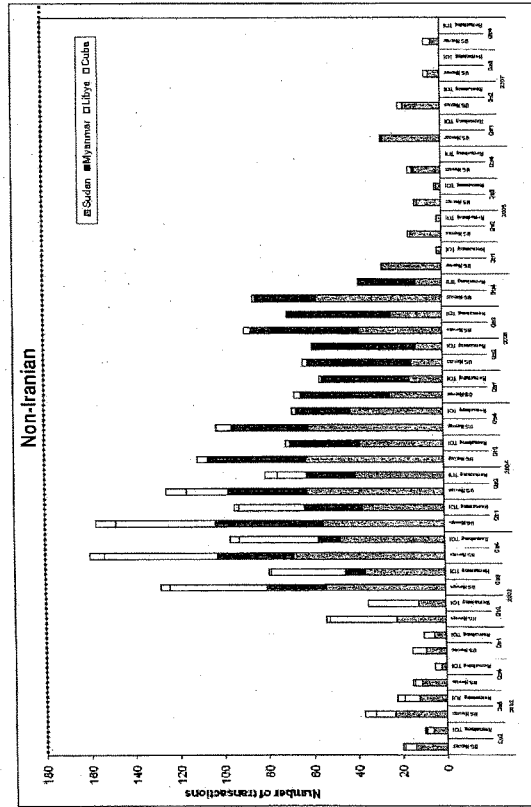
PAYMENTS RESULTS - IRANIAN TRANSACTIONS SENT VIA THE US BY YEAR



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March 29 2012 50

PAYMENTS RESULTS - NON-IRANIAN TRANSACTIONS SENT VIA THE US BY YEAR



Note: Country, city and port search terms have only been applied across the period June 1 2003 to December 31 2004. Country, city and port search terms make up approximately 25% by volume (11% by value) of identified US Nexus transactions.

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Confidential Treatment Requested HSBC-PSI-PROD-0197969

PAYMENT PROCESSING – CONSOLIDATED RESULTS

Reporting Category	Total Value \$'000 (Volume)	Permissible Transactions Value \$'000 (Volume)	Transactions of Interest Value \$'000 (Volume)	Potentially Licensable Value \$'000 (Volume)	Remaining Transactions of Interest Value \$'000 (Volume)
1. Payment with sanctioned element disclosed to the US	325,371 (1,395)	306,107 (1,257)	19,264 (138)	16,888 (46)	2,376 (92)
2. Cover payment – sanctioned element not disclosed to the US	3,920,304 (22,339)	3,553,661 (19,698)	366,643 (2,641)	132,258 (590)	234,385 (2,051)
3. Serial payment – sanctioned element not disclosed to the US	1,189,753 (659)	1,183,983 (569)	5,770 (90)	18 (3)	5,754 (87)
4. Cancelled and re-submitted without sanctioned element present in the message to the US	8,085 (128)	2,531 (60)	5,554 (68)	614 (22)	4,940 (46)
5. Other	47,858 (683)	38,366 (482)	9,492 (201)	4,061 (43)	5,431 (158)
Total	5,491,371 (25,204)	5,084,648 (22,066)	406,723 (3,138)	153,837 (704)	252,886 (2,434)

896

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Confidential Treatment Requested HSBC-PSI-PROD-0197976

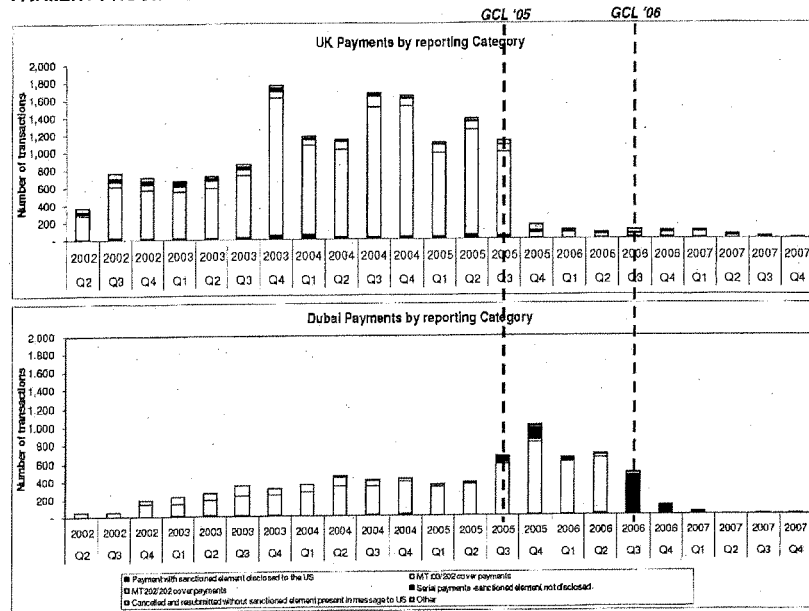
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March 29 2012 68



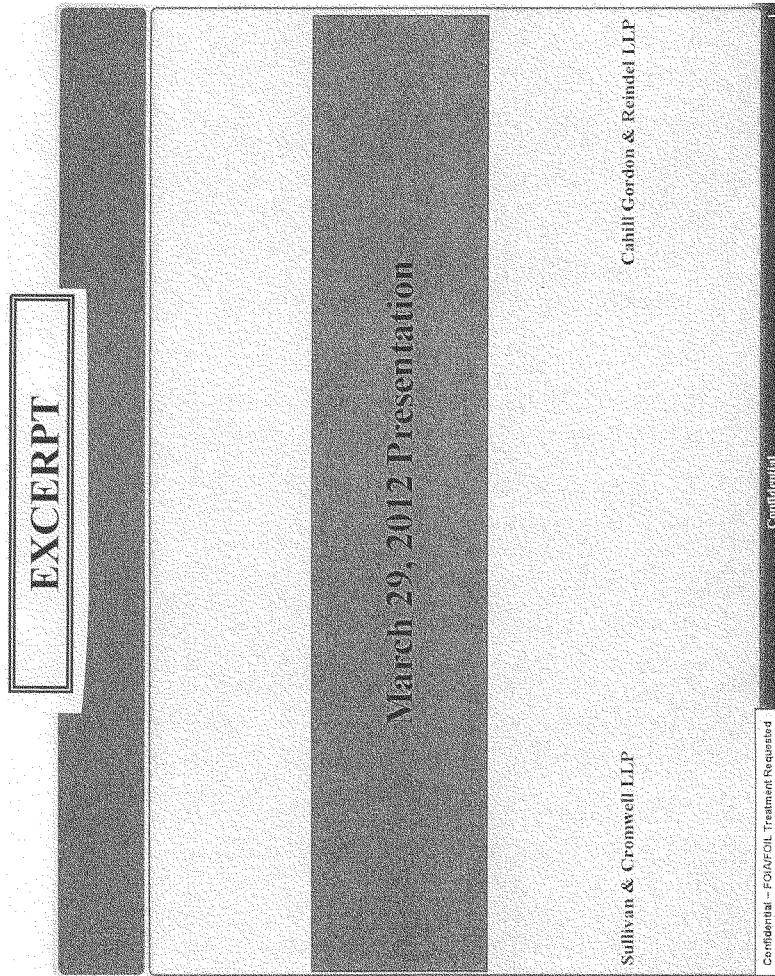
Confidential - FOIA Treatment Requested by HSBC N. America Holdings, Inc. HSB09340633  
Confidential Treatment Requested HSBC-PSI-PROD-0197980

# PAYMENT PROCESSING METHOD ANALYSIS RESULTS - UK & DUBAI PAYMENTS



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March 29 2012 62



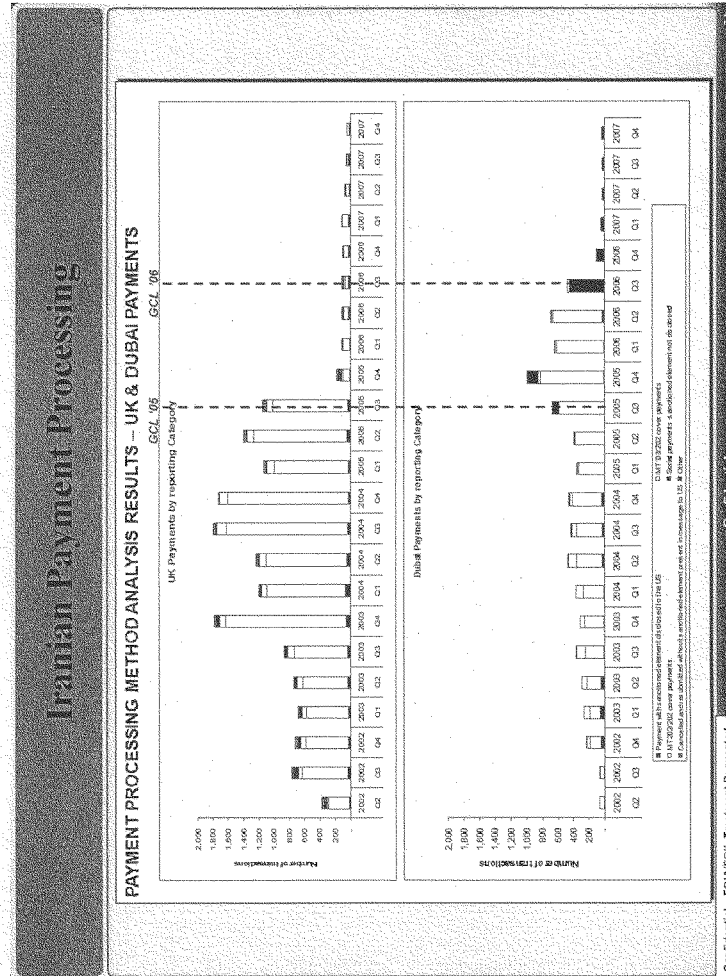
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 EXHIBIT #69  
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 ngs, Inc. HSB09340663  
 HSBC OCC 8966113

Payment Processing					
Systems at the U.K. Gateway					
PAYMENT PROCESSING – CONSOLIDATED (UK, DUBAI & OTHER COUNTRIES)					
Reporting Category	Total Value \$'000 (Volume)	Permissible Transactions Value \$'000 (Volume)	Transactions of Interest Value \$'000 (Volume)	Potentially Licensable Value \$'000 (Volume)	Remaining Transactions of Interest Value \$'000 (Volume)
1. Payment with sanctioned element disclosed to the US	325,367 (1,393)	306,103 (1,255)	19,264 (138)	15,868 (46)	2,376 (32)
2. Cover payment – sanctioned element not disclosed to the US	3,920,272 (22,350)	3,553,629 (19,694)	366,643 (2,647)	132,258 (990)	234,385 (2,051)
3. Serial payment – sanctioned element not disclosed to the US	1,189,753 (659)	1,163,983 (569)	5,770 (90)	16 (3)	5,754 (87)
4. Cancelled and re-submitted without sanctioned element present in the message to the US	8,085 (129)	2,543 (61)	5,542 (68)	582 (19)	4,960 (49)
5. Other	47,868 (683)	38,366 (482)	9,492 (201)	4,061 (43)	5,431 (158)
<b>Total</b>	<b>5,491,335 (25,199)</b>	<b>5,084,624 (22,061)</b>	<b>406,711 (3,138)</b>	<b>153,805 (701)</b>	<b>252,905 (2,437)</b>

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 Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSB09340693

## GCL 050047 - Compliance with sanctions (28/Jul/2005)

Language: Francais | Portuguese | Espanol | 中文

## Introduction

Group Standards Manual (GSM) 5.6 requires that all Group Offices comply with all anti-terrorism and crime legislation and with all economic and trade sanctions to the extent applicable pursuant to local laws and regulations.

In addition, however, Group Compliance (GHQ CMP) is required by the above section of the GSM to issue a circular advising all relevant Group Offices when any legislation or sanctions have extra-territorial effect.

## OFAC sanctions

The Office of Foreign Assets Control (OFAC) is a department of the US Department of the Treasury, and is responsible for the administration and enforcement of economic and trade sanctions based on US foreign policy. These sanctions target foreign countries, suspected terrorists, drugs traffickers and those engaged in the proliferation of weapons of mass destruction.

The OFAC sanctions consist of both country-level sanctions (including sanctions against Cuba, Iran, Zimbabwe, North Korea, Myanmar and Sudan) as well as sanctions against individuals (Specially Designated Nationals (SDNs)). There are variations in each of the statutes establishing the country-level sanctions such that there is no uniform approach (e.g. the Iran sanctions contain an exemption which is not applicable to other country-level sanctions).

## Revised policy

With immediate effect, all Group Offices (including those Offices incorporated or operating outside the US) must refuse to participate in any transactions and activities, or make any payments denominated in USD, which, if carried out by a US person, would be prohibited by any OFAC sanctions (except for the specific 'U-turn exemption' relating to Iranian sanctions discussed below).

When considering transactions for compliance with these sanctions, the transaction as a whole should be considered. This requires that where any transactions involve the use of cover payments (MT202s) any linked message (e.g. an MT103) should be considered together with the cover payment.

GHQ CMP already maintains a database, which includes details of all sanctions affecting Group Offices, including the OFAC sanctions. A link to the principal provisions of the current OFAC country sanctions is here

In addition, further advice, instructions and guidance, with regard to the principal provisions of the OFAC sanctions, will be issued by GHQ CMP to local Compliance functions to coincide with this GCL to enable those local Compliance functions to provide advice with regard to the practical application of this GCL.

Group Offices should, however, ensure that they continue to update relevant procedures in response to details of any future amendments or additions to applicable sanctions, including OFAC sanctions, issued by GHQ CMP in accordance with GSM 5.6. The guidance in this GCL should also be read in conjunction with GCL040074 US OFAC Sanctions, which discusses, among other things, how OFAC sanctions can apply to US citizens or permanent resident aliens, even when outside the US.

It is acknowledged that compliance with sanctions with extra-territorial reach, including OFAC sanctions, may be unlawful under local laws. Where compliance with this GCL would result in a breach of local law or regulation or existing binding contractual arrangements, the position should be considered in liaison with local Compliance and Legal functions and GHQ CMP. Any dispensation from the terms of this GCL requires GHQ CMP concurrence.

## Iranian sanctions

The OFAC sanctions applicable to Iran are unique in including the specific exemption for payments that qualify as a 'U-turn payment'. U-turn payments can be summarised as being 'cover payments involving Iran that are by order of a third country bank for payment to another third country bank - provided that they do not directly credit or debit an Iranian Account'. Iranian Accounts are defined as 'accounts of persons located in Iran or the Government of Iran contained on the books of a United States depository institution'. In this context, a third country bank must be non-US and non-Iranian and an Iranian Account generally includes an account for a non-Iranian subsidiary in which an Iranian company has a 30 per cent or greater interest. A more complete definition is contained in the guidance to be issued by GHQ CMP.

For the purposes of this GCL, 'Iranian Payments' mean payments made to or from an account maintained by any Iranian person (which includes any Iranian national, any individual resident in, or entity doing business in, Iran, or any entity incorporated or formed in Iran and subsidiaries of any Iranian entity), or an Iranian government body (including governmental-owned entities) whether directly or indirectly.

Permanent Subcommittee on Investigations  
EXHIBIT #70a

HSBC OCC 3407560  
HSBC OCC 3407561

In view, however, of the complexity of the relevant provisions governing the Iranian sanctions and the "U-turn exemption", all Iranian Payments denominated in USD must, with effect from 1 SEP05, or any earlier date notified by HBME DUB, be routed through HBME DUB - HSBC Middle East Management Office, Dubai Internet City, P O Box 66, Dubai, UAE, Tel. No. + [971] (4) 390 4722, which will establish a dedicated team to pre-screen proposed Iranian Payments for Compliance with the Iranian sanctions and process compliant payments via dedicated correspondent accounts. This will require Group Offices that wish to continue to make Iranian Payments to open USD accounts with HBME DUB. All requests to open accounts should be sent for the attention of Alan Kerr or Ahsan Raza, CIBM HBME. HBME DUB will issue more details to Group Offices as to how payments should be processed. With immediate effect, and prior to 1 SEP05, all Iranian payments must be referred to Rod Moxley, Tel. No. + [44] (0) 207 991 3664 (email Rod.MOXLEY@HSEJ/HSBC), and may only be processed once confirmation has been given that the payment is compliant under the "U-turn (or other) exemption".

#### Other sanctions with extra-territorial effect

GHQ CMP maintains a full and current list of sanctions that affect Group Offices. This list is accessible through the Group Compliance Intranet via this link or via local Compliance functions.

Although certain sanctions only apply locally, UN sanctions should be viewed as having Group-wide application. Sanctions issued by the European Union bind EU persons (individuals who are nationals of member states and companies incorporated or domiciled in member states) globally as well as those persons located or operating in member states. Group Offices should use WOLF or any alternative approved systems to load any additional names covered by local or other extra-territorial sanctions applicable to those offices.

#### Implementation

It is recognised that the use of automated payment screening systems is necessary for the effective identification of payments potentially subject to relevant sanctions, including OFAC sanctions. GCL 040021 Payment Screening required all Group Offices whose payments are not processed through one of the Group's 3 regional TP sites to install the Group's solution WOLF by 31 MAR05. The names loaded centrally by Group Messaging Systems will be supplemented by SAUG05 to include a full list of OFAC country and SDN names, thus ensuring that all cross-border USD payments Group-wide will be pre-screened for OFAC compliance. Group Offices should satisfy themselves that they are fully compliant with the requirements of GCL 040021 and notify GHQ CMP immediately of any deviation.

Where there are local USD clearing systems (e.g. Hong Kong and UAE), relevant offices must ensure that WOLF is capable of screening all local payments consistent with the requirements of this GCL in order to ensure that non-compliant payments are rejected. Those Group Offices with local USD clearing systems must conform to GHQ CMP by 1 NOV05 that they are screening all local USD payments.

In addition, Group Offices should take at least the following steps where relevant:

- Ensure that they have adequate procedures to identify proposed transactions and activities other than payments which may be prohibited by OFAC sanctions before the proposed transactions are entered into. This would include in-country book transfers over USD accounts. This may require the issuance of staff circulars, amendments to desk instruction books and local procedures manuals
- Once the SDN and country names are loaded into WOLF it is likely that the number of payments identified as potential matches to the OFAC sanctions will increase. Group Offices need to ensure that they are sufficiently resourced to consider any potential matches for clearance or rejection as appropriate
- Where proposed transactions or payments are identified that would breach the OFAC sanctions, non-US Group Offices should decline the transaction and refuse to make any payments returning the funds to the remitter. US Offices are normally required to block or freeze payments
- Consider, in conjunction with local Legal or Compliance functions, whether any amendments or additions should be made to product or service terms and conditions or whether any advance notification should be given to customers to clarify the bank's right and intention to reject or accept relevant instructions or requests
- Where Group Offices are in doubt as to whether a transaction or payment is affected by any sanction, but particularly OFAC sanctions, they should consult their local Compliance function which may in turn refer to GHQ CMP
- It should be noted that the policy contained in this GCL, where it relates to OFAC sanctions, only applies to transactions or payments denominated in USD, except for those US Offices which are required to apply OFAC sanctions to all transactions regardless of the currency of denomination
- Note the specific arrangements required in relation to payments that might be subject to the OFAC sanctions applicable to Iran.

Yours faithfully

S K Green  
Group Chief Executive

## GCL 050047 - Compliance with sanctions (28/Ju/2005)

Langue: Français | Português | Español | English

## Introduction

Group Standards Manual (GSM) 5.6 requires that all Group Offices comply with all anti-terrorism and crime legislation and with all economic and trade sanctions to the extent applicable pursuant to local laws and regulations.

In addition, however, Group Compliance (GHC) is required by the above section of the GSM to issue a circular advising all relevant Group Offices when any legislation or sanctions have extra-territorial effect.

## OFAC sanctions

The Office of Foreign Assets Control (OFAC) is a department of the US Department of the Treasury, and is responsible for the administration and enforcement of economic and trade sanctions based on US foreign policy. These sanctions target foreign countries, suspected terrorists, drug traffickers and those engaged in the proliferation of weapons of mass destruction.

The OFAC sanctions consist of both country-level sanctions (including sanctions against Cuba, Iran, Zimbabwe, North Korea, Myanmar and Sudan) as well as sanctions against individuals (Specially Designated Nationals (SDNs)). There are variations in each of the sanctions establishing the country-level sanctions such that there is no uniform approach (e.g. the Iran sanctions contain an exemption which is not applicable to other country-level sanctions).

## Revised policy

With immediate effect, all Group Offices (including those Offices incorporated or operating outside the US) must refuse to participate in any transactions and activities, or make any payments denominated in USD, which, if carried out by a US person, would be prohibited by any OFAC sanctions (except for the specific "U-turn exemption" relating to Iranian sanctions discussed below).

When considering transactions for compliance with these sanctions, the transaction as a whole should be considered. This requires that where any transactions involve the use of cover payments (MT202s) any linked message (e.g. an MT103) should be considered together with the cover payment.

GHC CMP already maintains a database, which includes details of all sanctions affecting Group Offices, including the OFAC sanctions. A link to the principal provisions of the current OFAC country sanctions is here

In addition, further advice, instructions and guidance, with regard to the principal provisions of the OFAC sanctions, will be issued by GHC CMP to local Compliance Functions to coincide with this GCL to enable these local Compliance Functions to provide advice with regard to the practical application of this GCL.

Group Offices should, however, ensure that they continue to update relevant procedures in response to details of any future amendments or additions to applicable sanctions, including OFAC sanctions, issued by GHC CMP in accordance with GSM 5.6. The guidance in this GCL should also be read in conjunction with GCL 040074 US OFAC Sanctions, which discusses, among other things, how OFAC sanctions can apply to US citizens or permanent resident aliens, even when outside the US.

It is acknowledged that compliance with sanctions with extra-territorial reach, including OFAC sanctions, may be unlawful under local laws. Where compliance with this GCL would result in a breach of local law or regulations or existing binding contractual arrangements, the position should be considered in liaison with local Compliance and Legal functions and GHC CMP. Any dispensation from the terms of this GCL requires GHC CMP concurrence.

## Iranian sanctions

The OFAC sanctions applicable to Iran are unique in including the specific exemption for payments that qualify as a "U-turn payment". U-turn payments can be summarised as being "cover payments involving Iran that are by order of a third country bank for payment to another third country bank - provided that they do not directly credit or debit an Iranian Account". Iranian Accounts are defined as "accounts of persons located in Iran or the Government of Iran conducted on the books of a United States depository institution". In this context, a third country bank must be non-US and non-Iranian and an Iranian Account generally includes an account, for a non-Iranian subsidiary in which an Iranian company has a 30 per cent or greater interest. A more complete definition is contained in the guidance to be issued by GHC CMP.

For the purposes of this GCL, "Iranian Payments" mean payments made to or from an account maintained by any Iranian person (which includes any Iranian natural or legal person, or entity doing business in Iran, or any entity incorporated or formed in Iran and subsidiaries of any Iranian entity), or an Iranian government body (including governmental-owned entities) whether directly or indirectly.

In view, however, of the complexity of the relevant provisions governing the Iranian sanctions and the "U-turn exemption", all Iranian Payments denominated in USD must, with effect from 1 SEP 05, or any earlier date notified by HSBC DUB, be routed through HSBC DUB - HSBC Middle East Management Office, Dubai Internet City, P O Box 66, Dubai, UAE, Tel. No. + (971) (4) 350 4722, which will establish a dedicated team to pre-screen proposed Iranian Payments for compliance with the Iranian sanctions and process compliant payments via dedicated correspondent accounts. This will require Group Offices that wish to continue to make Iranian Payments to open USD accounts with HSBC DUB. All requests to open accounts should be sent to the attention of Alan Kerr or Abbas Raza, CIBN HSBC, HSBC DUB who will issue more details to Group Offices as to how payments should be processed. With immediate effect, and prior to 1 SEP 05, all Iranian payments must be referred to Alan Kerr, Tel. No. + (44) (0) 207 993 3664 (email: ALAN.KERR@HSBC), and may only be processed once confirmation has been given that the payment is compliant under the "U-turn (or other) exemption".

## Other sanctions with extra-territorial effect

GHC CMP maintains a full and current list of sanctions that affect Group Offices. This list is accessible through the Group Compliance Intranet via this link or via local Compliance functions.

Although certain sanctions only apply locally, UN sanctions should be viewed as having Group-wide application. Sanctions issued by the European Union bind EU persons (individuals who are nationals of member states and companies incorporated or domiciled in member

<http://group.ghc.hsbc/group/home.nsf/ByRef/UKCM7GDSB031803PM07092008?Open> 03/11/2010

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GCL 050047

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states) globally as well as those persons located or operating in member states. Group Offices should use WOLF or any alternative approved systems to load any additional names covered by local or other extra-territorial sanctions applicable to those offices.

#### Implementation

It is recognized that the use of automated payment screening systems is necessary for the effective identification of payments potentially subject to relevant sanctions, including OFAC sanctions. GCL 040221 Payment Screening required all Group Offices whose payments are not processed through one of the Group's 3 regional TP offices to install the Group's solution WOLF by SIMARIS. The names loaded centrally by Group Messaging Systems will be supplemented by SAUNDERS to include a full list of OFAC country and SDN names, thus ensuring that all cross-border USD payments Group-wide will be pre-screened for OFAC compliance. Group Offices should satisfy themselves that they are fully complying with the requirements of GCL 040221 and notify GHQ CHP immediately of any deviations.

Where there are local USD clearing systems (e.g. Hong Kong and UAE), relevant offices must ensure that WOLF is capable of screening all local payments consistent with the requirements of this GCL. In order to ensure that non-compliant payments are rejected, those Group Offices with local USD clearing systems must confirm to GHQ CHP by 1 NOV05 that they are screening all local USD payments.

In addition, Group Offices should take at least the following steps where relevant:

- Ensure that they have adequate procedures to identify proposed transactions and activities other than payments, which may be prohibited by OFAC sanctions before the proposed transactions are entered into. This would include in-country book transfers over USD accounts. This may require the issuance of staff circulars, amendments to desk instruction books and local procedures manuals.
- Once the SDN and country names are loaded into WOLF it is likely that the number of payments identified as potential matches to the OFAC sanctions will increase. Group Offices need to ensure that they are sufficiently resourced to consider any potential matches for clearance or rejection as appropriate.
- Where proposed transactions or payments are identified that would breach the OFAC sanctions, non-US Group Offices should decline the transaction and refer to make any payments retaining the funds to the remitter. US Offices are normally required to block or freeze payments.
- Consider, in conjunction with local Legal or Compliance functions, whether any amendments or additions should be made to product or service terms and conditions or whether any advance notification should be given to customers to clarify the bank's right and intention to reject or accept relevant instructions or requests.
- Where Group Offices are in doubt as to whether a transaction or payment is affected by any sanction, but particularly OFAC sanctions, they should consult their local Compliance function which may in turn refer to GHQ CHP.
- It should be noted that the policy contained in this GCL, where it relates to OFAC sanctions, only applies to transactions or payments denominated in USD, except for those US Offices which are required to apply OFAC sanctions to all transactions regardless of the currency of denomination.
- Note the specific arrangements required in relation to payments that might be subject to the OFAC sanctions applicable to Iran.

Yours faithfully

S K Green  
Group Chief Executive

<http://group.ghq.hsbc/group/home.nsf/ByRef/UKCM7GDJSB031803PM07092008?Open> 03/11/2010

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**GCL 050011 - US Dollar Payments (06/Apr/2006)**

Langue: Français | Portuguese | Español | 简体中文

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**Introduction**

GCL 050047 'Compliance with Sanctions' reiterated Group Policy with regard to Compliance with local and international sanctions by Group Offices, including sanctions issued by the US Office of Foreign Assets Control (OFAC). Group Policy arising from the above GCL prohibits any Group Office from initiating any payment denominated in US Dollars (USD) that would constitute a breach of any of the OFAC sanctions.

US regulatory authorities continue to focus closely upon Compliance with OFAC sanctions by US banks, particularly where they act as correspondent banks for non-US banks, and by foreign banks with US operations.

**Payment Methodology**

USD payments made on behalf of underlying customers can be made either as cover payments (MT103 + linked MT202) or as serial payments (two MT103s). An illustration of both payment types, using the same underlying transaction, is shown in Appendix 1. Where cover payments are used, the payment message passing via the US correspondent (MT202) makes no mention of the underlying remitter or beneficiary. This is contained in the linked MT103 message which passes outside USA.

**Policy**

1. With effect from 30APR06 all USD payments initiated by a Group Office and remitted via HBUS, or any other US correspondent, must be made as serial payments.
2. The requirement to make payments as serial payments does not vary the provisions of GCL 050047 in that only USD payments permitted by OFAC may be initiated or processed by a Group Office.
3. The above requirements do not restrict the use of cover payments (MT202) for genuine bank-to-bank payments, for example in relation to Foreign Exchange settlements.
4. Until further notification, U-turn payments, under the Iran country OFAC sanctions, should also continue to be made as cover payments (MT103 + linked MT202) as serial payments cannot qualify as U-turn payments. In accordance with GCL 050047, all U-turn payments must continue to be made via HBME DUB. Where U-turn payments are made, field 72 of the Swift payment message must be completed so as to make reference to any linked MT103.
5. By 31DEC06 HBUS will require third-party banks to which HBUS provide USD correspondent banking services to make all payments denominated in USD and remitted via HBUS as serial payments.
6. Any dispensations from the requirements of this GCL require approval by GHQ CMP with agreement from HBUS CMP where relevant.

**Guidance**

Detailed guidance is to be issued via GHQ CMP, and any enquiries with regard to the implementation of this GCL or relating to GCL 050047 should be referred to local Compliance Officers, who can, as required, seek further clarification from GHQ CMP.

Yours faithfully

Stephen K Green  
Group Chief Executive

HSBC OCC 3407587

Permanent Subcommittee on Investigations <b>EXHIBIT #70b</b>
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GCL 060011

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**GCL 060011 - US Dollar Payments (06/Apr/2008)**

Language: French | Portuguese | Expand | PDF

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**Introduction**

GCL 060047 "Compliance with Sanctions" reiterated Group Policy with regard to Compliance with local and international sanctions by Group Offices, including sanctions issued by the US Office of Foreign Assets Control (OFAC). Group Policy arising from the above GCL prohibits any Group Office from initiating any payment denominated in US Dollars (USD) that would constitute a breach of any of the OFAC sanctions.

US regulatory authorities continue to focus closely upon Compliance with OFAC sanctions by US banks, particularly where they act as correspondent banks for non-US banks, and by foreign banks with US operations.

**Payment Methodology**

USD payments made on behalf of underlying customers can be made either as cover payments (MT103 + linked MT202) or as serial payments (two MT103s). An illustration of both payment types, using the same underlying transaction, is shown in Appendix 1. Where cover payments are used, the payment message passing via the US correspondent (MT202) makes no mention of the underlying remitter or beneficiary. This is contained in the linked MT103 message which passes outside USA.

**Policy**

1. With effect from 30APR06 all USD payments initiated by a Group Office and remitted via HBUS, or any other US correspondent, must be made as serial payments.
2. The requirement to make payments as serial payments does not vary the provisions of GCL 060047 in that only USD payments permitted by OFAC may be initiated or processed by a Group Office.
3. The above requirements do not restrict the use of cover payments (MT202) for genuine bank-to-bank payments, for example in relation to Foreign Exchange settlements.
4. Until further notification, U-turn payments, under the Iran country OFAC sanctions, should also continue to be made as cover payments (MT103 + linked MT202) as serial payments cannot qualify as U-turn payments. In accordance with GCL 060047, all U-turn payments must continue to be made via HBME DUB. Where U-turn payments are made, Field 72 of the Swift payment message must be completed so as to make reference to any linked MT103.
5. By 31DEC06 HBUS will require third-party banks to which HSUS provide USD correspondent banking services to make all payments denominated in USD and remitted via HBUS as serial payments.
6. Any dispensations from the requirements of this GCL require approval by GHQ CMP with agreement from HBUS CMP where relevant.

**Guidance**

Detailed guidance is to be issued via GHQ CMP, and any enquiries with regard to the implementation of this GCL or relating to GCL 060047 should be referred to local Compliance Officers, who can, as required, seek further clarification from GHQ CMP.

Yours faithfully

Stephen K Green  
Group Chief Executive

<http://group.ghq.hsbc/group/home.nsf/ByRef/UKCM7GFAU8083122AM07112008?Open> 03/11/2010

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## GCL 050041 - US OFAC Sanctions against Iran - U-Turn Exemption (25/Oct/2006)

Language: Français | Portuguese | Español | 繁體中文

## Background

The Office of Foreign Assets Control (OFAC) of the US Department of the Treasury is responsible for the administration and enforcement of economic and trade sanctions based on US foreign policy. These sanctions target specified countries, suspected terrorists, drugs traffickers and those engaged in the proliferation of weapons of mass destruction.

The OFAC sanctions include country-level sanctions against a number of countries including Iran. The regulations contain an exemption to the sanctions unique to Iran, the so-called "U-turn exemption" for payments that qualify as a "U-turn payment". U turn payments can be summarised as being 'cover payments involving Iran that are by order of a third country bank for payment to another third country bank - provided that they do not directly credit or debit an Iranian Account' (as defined in the regulations). This U-turn exemption is described fully in GCL 050047 (Compliance With Sanctions).

## Revised policy

With immediate effect, all Group Offices (including offices incorporated or operating outside the US) may no longer use the U-turn exemption of the OFAC sanctions against Iran. All other requirements of GCL 050047 remain in force.

Valid U-turn payments can continue to be made in relation to binding contractual commitments (i.e. that cannot be amended or terminated) that pre-date this GCL, provided that these payments are processed through HBME as per GCL 050047. Where a U-turn payment is made it must be through the serial method pursuant to GCL 060011 (US Dollar Payments).

Also refer to related GCLs: GCL 040074 (US OFAC Sanctions - Applicability to US Citizens, wherever located, and other US Persons) and GCL 060011, where appropriate.

Yours faithfully

D H Hodgkinson  
Group Chief Operating Officer

HSBC OCC 3407606

Permanent Subcommittee on Investigations  
EXHIBIT #70c

GCL 060041

Page 1 of 1

**GCL 060041 - US OFAC Sanctions against Iran - U-Turn Exemption (25/Oct/2006)**

Language: French | Portuguese | Spanish | Zulu

**Background**

The Office of Foreign Assets Control (OFAC) of the US Department of the Treasury is responsible for the administration and enforcement of economic and trade sanctions based on US foreign policy. These sanctions target specified countries, suspected terrorists, drugs traffickers and those engaged in the proliferation of weapons of mass destruction.

The OFAC sanctions include country-level sanctions against a number of countries including Iran. The regulations contain an exemption to the sanctions unique to Iran, the so-called "U-turn exemption" for payments that qualify as a U-turn payment. U-turn payments can be summarized as being "over payments involving Iran that are by order of a third country bank for payment to another third country bank - provided that they do not directly credit or debit an Iranian Account" (as defined in the regulations). This U-turn exemption is described fully in GCL 060047 (Compliance with Sanctions).

**Revised policy**

With immediate effect, all Group Offices (including offices incorporated or operating outside the US) may no longer use the U-turn exemption of the OFAC sanctions against Iran. All other requirements of GCL 060047 remain in force.

Valid U-turn payments can continue to be made in relation to binding contractual commitments (i.e. that cannot be amended or terminated) that pre-date this GCL, provided that these payments are processed through HBME as per GCL 060047. Where a U-turn payment is made it must be through the serial method pursuant to GCL 060011 (US Dollar Payments).

Also refer to related GCLs: GCL 040074 (US OFAC Sanctions - Applicability to US Citizens, wherever located, and other US Persons) and GCL 060011, where appropriate.

Yours faithfully

D H Huddy  
Group Chief Operating Officer

<http://group.glb.hsbc/group/home.nsf/ByRef/UKCM7GEKAX033659PM07102008?Open> 03/11/2010

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Group > News Desk > Group Circular Letters > GCL 070049

### GCL 070049 - Sanctions Against Iran (24/Sep/2007)

Language: Français | Portuguese | Español | 繁體中文

#### Background

GCLs 050047 and 060041 referred to compliance with economic and trade sanctions to the extent applicable pursuant to local laws and regulations and the application of certain Group minimum required standards in relation to transactions and payments denominated in US dollars. These GCLs remain in full force and effect.

#### Policy

Reflecting the current international and political situation and the potential risk of the inadvertent involvement of Group companies in transactions, payments or activities linked to the proliferation of weapons of mass destruction (WMD) and nuclear proliferation a decision has been taken to suspend all services and business with Iranian banks, irrespective of currency to the extent and as detailed below.

#### Relationships with Iranian Banks

All account relationships with Iranian Banks must be closed as soon as possible after giving any period of notice required by local law or regulation and which is sufficient to allow an orderly run down of activity (for example uncleared items), and the run-off of any outstanding exposures. In any event such accounts must be closed by 30NOV07.

Similarly, any remaining facilities extended to Iranian Banks and SWIFT BKE arrangements should be cancelled or withdrawn as soon as possible and in any event by 30NOV07.

Where local law or the need to manage exit in an orderly manner will require accounts/SWIFT KEYS to be maintained beyond 30NOV07 specific dispensation must be obtained from GHQ CMP.

Pending closure of accounts and cancellation of SWIFT BKEs any payments debited to accounts held for Iranian Banks, regardless of currency, should be made as MT103 serial payments.

#### Existing Facilities and Transactions

All existing facilities and transactions where there are legally binding commitments should continue to be honoured. Such arrangements may include committed facilities (for example Project and Export Finance facilities), existing guarantees (see below) and Documentary Credits issued, advised or confirmed. Any payments linked to such pre-existing commitments may be made, but as serial payments.

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OCC-PSI-00141531

Permanent Subcommittee on Investigations  
**EXHIBIT #70d**

Where there are pre-existing guarantees issued on a pay or extend basis supporting business with Iran these may exceptionally continue to be extended provided that:

Group Offices review each such guarantee and are satisfied that the underlying transaction is not linked to WMD or nuclear proliferation.

Each such guarantee must be reviewed on each extension and customers encouraged to negotiate alternative arrangements.

#### New Business Involving Iran

No new business should be entered into in respect of any transactions involving Iran, Iranian resident entities or Iranian goods subject to the detailed policy guidance issued by GTS simultaneously with this GCL.

#### Further Guidance

Further guidance in respect of FIG relationships can be obtained from FIG Dubai and/or FIG London (Client Management Group). For guidance on payments into or out of Iranian banks and for all other matters, contact your local Compliance function.

Yours faithfully

D H Hodgkinson

Group Chief Operating Officer

GCL 070049

Page 2 of 3

Group &gt; News Desk &gt; Group Circular Letters &gt; GCL 070049

GCL 070049 - Sanctions Against Iran (24/Sep/2007)

Language: (French) (Portuguese) (Spanish) (Chinese)

## Background

GCLs 050047 and 060041 referred to compliance with economic and trade sanctions to the extent applicable pursuant to local laws and regulations and the application of certain Group minimum required standards in relation to transactions and payments denominated in US dollars. These GCLs remain in full force and effect.

## Policy

Reflecting the current international and political situation and the potential risk of the inadvertent involvement of Group companies in transactions, payments or activities linked to the proliferation of weapons of mass destruction (WMD) and nuclear proliferation a decision has been taken to suspend all services and business with Iranian banks, irrespective of currency to the extent and as detailed below.

## Relationships with Iranian Banks

All account relationships with Iranian Banks must be closed as soon as possible after giving any period of notice required by local law or regulation and which is sufficient to allow an orderly run-down of activity (for example uncleared items), and the run-off of any outstanding exposures. In any event such accounts must be closed by 30/09/07.

Similarly, any remaining facilities extended to Iranian Banks and SWIFT BKE arrangements should be cancelled or withdrawn as soon as possible and in any event by 30/09/07.

Where local law or the need to manage exit in an orderly manner will require accounts/SWIFT keys to be maintained beyond 30/09/07 specific dispensation must be obtained from GHQ OMP.

Pending closure of accounts and cancellation of SWIFT BKEs any payments debited to accounts held for Iranian Banks, regardless of currency, should be made as MT103 serial payments.

## Existing Facilities and Transactions

All existing facilities and transactions where there are legally binding commitments should continue to be honoured. Such arrangements may include committed facilities (for example project and export finance facilities), existing guarantees (see below) and Documentary Credits issued, advised or confirmed. Any payments linked to such pre-existing commitments may be made, but as serial payments.

Where there are pre-existing guarantees issued on a pay or extend basis supporting business with Iran these may exceptionally continue to be extended provided that:

Group Offices review each such guarantee and are satisfied that the underlying transaction is not linked to WMD or nuclear proliferation.

Each such guarantee must be reviewed on each extension and customers encouraged to negotiate alternative arrangements.

## New Business Involving Iran

No new business should be entered into in respect of any transactions involving Iran, Iranian resident entities or Iranian goods subject to the detailed policy guidance issued by GTS simultaneously with this GCL.

## Further Guidance

Further guidance in respect of FIG relationships can be obtained from FIG Dubai and/or FIG London (Client Management Group). For guidance on payments into or out of Iranian banks and for all other matters, contact your local Compliance function.

Yours faithfully

D H Hodgkinson

Group Chief Operating Officer

<http://group.ghq.hsbc/group/home.nsf/ByRef/UKCM7GJLP6045523PM07142008?Open> 06/03/2010

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Confidential &amp; non-public OCC information

OCC-PSI-00141530  
OCC-PSI-00141531

From: Rod MOXLEY  
 Sent: Fri Sep 23 16:57:38 2005  
 To: John ALLISON; John F ROOT  
 Cc: Jeremy R WALKER; Jim F EBDON  
 Subject: OFAC sanctions  
 Importance: Normal  
 Attachments: image\_0.gif

John,

You will be aware that I am keen to ensure that implementation of the GCL 050047 is carried out both professionally and efficiently. To this end, I have requested my colleague Jeremy Walker to supply MI for affected USD payments over a 10 day period (5 a round the time of implementation of the GCL and 5 more recently), so that I can review and address any issues arising.

These figures, which you may find interesting, are detailed below:



	12/09/05	13/09/05	14/09/05	15/09/05	16/09/05
Sudan	406	478	371	353	382
Iran	181	155	185	126	172
Cuba	144	236	220	169	144
Myanmar	0	0	0	31	
<b>TOTAL</b>	<b>731</b>	<b>869</b>	<b>776</b>	<b>650</b>	<b>729</b>

To clarify, these figures constitute the number of payment transactions which have been identified by Wolf in UK as being possible hits. The figure shown will include both MT202 and MT103 messages (so there is an element of double counting in the figures supplied, as a typical single customer transaction will have both an MT103 and an MT202) and is for all currencies-not purely USD -on a particular day.

In particular regard to the Sudanese payments, but also to a lesser extent, Cuban and Burmese, there are a considerable number of USD denominated transactions. The precise amount is difficult to quantify, unless manual counts are made and as you will appreciate, this is difficult in a volume driven payments environment. Until 28 July, the above payments would have been filtered by Wolf and providing they did not infringe UN/ EU sanctions or terrorist parameters, they were paid on the basis that HBEU were not affected directly by OFAC sanctions.

Since the issuance of the GCL, it has been made clear that US interests are of paramount importance and we should do nothing, when processing payment transactions, which would leave HBUS in a vulnerable position. The issues surrounding Iran have overshadowed other OFAC payments recently, however, I can advise that we have not so far physically returned any USD payments involving Sudan, Cuba or Burma. I feel we now need to look far more closely at these payments to ensure compliance with the GCL.

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 EXHIBIT #71a

HSBC OCC 8877213



The choice at present, from my viewpoint, with regard to application of the GCL in respect of these payments is this:

1. We continue to process the USD transactions but ensure that the method of routing of the payments is such that they are not frozen in US. This will involve intelligent usage of the routing system but may perpetuate similar scenarios to those encountered with Iran (customer instructions saying Do not mention Sudan or routing which does not make it apparent that these are Sudanese payments). This would create the exact scenarios illustrated in Compliance's guidance examples re Sudan i.e. the payment is prohibited under the sanction but is made because it pays a USD account outside the US.
2. We apply strictly the wording of the GCL "...refuse to participate in any transactions and activities, or make any payments denominated in USD, which, if carried out by a US person, would be prohibited by any OFAC sanctions..." and return the payments unprocessed.

My instinct is to return all such USD payments but, before doing so, I would like confirmation that there should not be a cooling off period when we continue to make such payments, pending the Relationship Managers' advice to their customer base. Additionally, I want to be sure that I am correct in thinking that we should be "adopting" OFAC sanctions in these situations and not merely "interpreting" the OFAC sanctions so that our US colleagues' position is not compromised. It is perhaps also worth bearing in mind that OFAC sanctions are not limited to USD and if we made a Euro payment to Citibank in favour of Sudan, we should likewise be cancelling such payments.

I have spoken to a number of RMs recently and, rightly or wrongly, there is little or no knowledge of the practical implications of the GCL. The BPM is yet to be updated and so it has not crossed the line of vision of many RMs. This does mean that, if we refuse to process OFAC related USD payments forthwith, the first time the customer will be aware will be when his payment rejects at our Volf queue. This could cause considerable customer servicing issues, particularly if it involves large corporates or valued private customers.

To reiterate my stance above, I am keen to ensure that this is progressed professionally, and with minimum risk, but I am acutely aware that whichever route I take may have other repercussions, albeit unwittingly. I feel that David Bagley should be made aware of this situation but before advising him directly I thought it sensible to involve yourselves, so that practical remedial action can be drawn up.

I would be grateful for your input, perhaps a short meeting to prevent protracted email correspondence could be arranged, but I will await your views.

Regards

Rod

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HSBC OCC 8877214



INFORMATION REQUESTED IN CONNECTION WITH: (NORTH KOREA,  
CUBA, AND MYANMAR)

1. Description of the past and current business activities contributing to revenues from the country, together with a description of the businesses and contacts contributing to these revenues. This should include, but not be limited to, details of the entities and projects to which you have provided financing.

**HBMY - Mexico**

We were notified that there are relationships with Cuban and North Korean customers. MLD requested the cancellation of their accounts, and followed up all the process until such accounts denominated in USD were cancelled. As of today, we have found 108 North Korean customers with balances of USD3.11Mn and 1,368 Cuban customers with balances in the amount of USD10.21Mn. Please note that the principal is denominated in MXP.

Please find below an updated list of relationships with Cuban and North Korean citizens:

**Total number of customers by Jurisdiction, (figures in USD)**

JURISDICTION	Customer Type /currency	No. Customers	No. Accounts	USD Balances
North Korea		108	174	3,119,100.26
	MXP	92	137	697,004.34
	Both MXP and USD	7	28	2,374,988.17
	USD	9	9	46,507.25
Cuba		1368	2468	10,215,776.14
	MXP	1284	2249	8,500,194.29
	Both MXP and USD	61	194	966,656.77
	USD	23	25	348,919.07
<b>Total</b>		<b>1,476</b>	<b>2,642</b>	<b>13,334,876.40</b>

Balances as of 11MAY07

Note: the above figures have been sent to business units so that they will verify the nationality of the above relationships, and so as to confirm their migratory status since we have detected that some of them have been naturalized as Mexican citizens.

Permanent Subcommittee on Investigations  
**EXHIBIT #71b**

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HSBC OCC 8876093

— = Redacted by the Permanent  
Subcommittee on Investigations



#### HBFA - Panama

HSBC Bank Panama S.A. does not have relationships with customers of the aforementioned nationalities.

Benitmo Panama has the following relationships with Cuban nationals who reside in Panama:

Deposit Accounts with balances of USD 185K  
Credit Cards with balances of USD 39K  
Mortgages in the amount of USD 240K

The accounts of Cuban nationals are expected to be cancelled on 30JUN07.

Credit Cards of Benitmo Panama that are authorized to process transactions in Cuba are expected to be cancelled on 30JUN07.

#### HBPE - Peru

HBPE does not have any relationships either with the above jurisdictions, banks nor governments.

#### HBCO - Colombia

There is one relationship with [REDACTED] its main transactions are related to [REDACTED] but it does not have loans with the bank. (They neither make transfers to Cuba nor receive remittances. Their deposits are denominated in local currency). There is an account denominated in local currency with a balance of [REDACTED]

#### HBHN - Honduras

There is one business relationship with [REDACTED]. They maintain a savings account denominated in USD that was opened on 24-Dec-02 with a balance as of 21MAY in the amount of USD93K. The transactions executed by them are cash deposits, cash withdrawals that are exchanged into local currency for [REDACTED]

In addition, there is one commercial relationship with 44 Cuban nationals with the following balances:

Accounts denominated in USD: USD 211K  
Accounts denominated in local Currency (Lempiras): USD 23K

#### HBCR - Costa Rica

There is one commercial relationship with 32 Cuban customers who have different savings and debit accounts denominated in USD with balances of USD11.6K and credit cards with balances in the amount of USD 5.5K.



#### HBSE - El Salvador

There is one relationship with a Cuban national (A savings account denominated in local currency -Colón salvadoreño- with a balance of 1 SD23.12.)

#### HBNI - Nicaragua

Nicaragua does not execute - has not executed transactions with Cuban, North Korean, or Myanmar nationals - entities.

#### Bahamas

Bahamas reports that it does not have any relationships with Cuban nationals.

#### II. Any new developments or future anticipated business activities related to, or contacts with, the countries listed.

For the entire region, all necessary arrangements have been made to cancel all business relationships with the above jurisdictions, either in relation to accounts denominated in USD or commercial relationships with such jurisdictions. There are not new business relationships to be opened with the above jurisdictions.

#### III. A description of direct or indirect contacts with the governments of the named countries and with individuals or entities affiliated with or controlled by those governments, and the uses made by those parties of funds received in the related transactions.

For the entire region, formal relationships maintained with such jurisdictions are with the embassies, as shown in section I herof.

#### IV. Quantification for each of 2003, 2004, 2005 and 2006 of:

- (a) revenues from the country;
- (b) profitability of the country (please advise any significant estimates used in allocating costs); and
- (c) total assets in the country.

No available information.

#### V. Details as to whether the activities identified are subject to customer confidentiality.

For the entire region, confidentiality restrictions are applicable and information may not be provided unless it is requested by the regulator.

From: David W J BAGLEY  
 Sent: Mon Oct 17 17:13:57 2005  
 To: John F ROOT  
 Subject: Re: GCL 050047 - Compliance with Sanctions  
 Importance: Normal  
 Attachments: image\_0.gif Doc Link.htm

John,

As per my earlier note.

Regards

----- Forwarded by David W J BAGLEY/HGHQ/HSBC on 17 Oct 2005 16:54 -----

Memo  
 17 Oct 2005 16:40

From: Matthew J W KING/GGM INA GHQ/HGHQ/HSBC Tel: 7902 1176; 44  
 2079 921176

Graham THOMSON et al

To: Graham THOMSON/HBMX/HSBC@HSBC  
 cc: David Leighton/HBMX/HSBC@HSBC  
 Ramon GARCIA/HBMX/HSBC@HSBC  
 Sandy Flockhart/HBMX/HSBC@HSBC  
 Sergio PINA/HBMX/HSBC@HSBC  
 David W J BAGLEY/HGHQ/HSBC@HSBC  
 bcc:

Subject: Re: GCL 050047 - Compliance with Sanctions

Graham,

Thank you for the update.

Sandy collared me on this last week. I told him then, and I have since confirmed, that the new policy applies specifically only to USD payments. However, I have now been advised there is also an issue for non-USD payments where these are transmitted through the HBUS TP gateway, as is the case in South America. Fernando Busnello is dealing with this on behalf of HBBR/HBAR and you may like to talk to him directly if HBMX payments are similarly routed.

I note HBMX continues to process USD payments involving Cuba. It is very important this is stopped immediately as the regulators are getting very tough and the cost to the Group could be considerable if a

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EXHIBIT #71c

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HSBC OCC 8874357

breach occurs, both in terms of the fine and in the rectification work which is likely to be a pre-requisite to any settlement. If this identifies further breaches, the cost could spiral.

With regard to non-USD payments as described above, GHQ CMP are urging HBUS to screen out these transactions to avoid any risk, and HBMX would have to put measures in place to per-empt customer dismay.

I am happy to discuss further.

Regards

Matthew

Graham THOMSON/HBMX/HSBC

Graham THOMSON/HBMX/HSBC HBMX  
14/10/2005 17:55 Mail Size: 24601

To: Matthew J W KING/GGM INA GHQ/HGHQ/HSBC@HSBC cc: Sandy Flockhart/HBMX/HSBC@HSBC, Ramon GARCIA/HBMX/HSBC@HSBC, David Leighton/HBMX/HSBC@HSBC, Sergio PINA/HBMX/HSBC@HSBC Subject: Re: GCL 050047 - Compliance with Sanctions Entity HSBC Holdings plc - HGHQ

Matthew

I have received the following commentary from HBMX CMP, which I relay in response to your query

#### OFAC List Verification Implementation

##### Background:

The implementation of the "OFAC" list as directed by GCL050047 has not been completely accomplished. This is due to the fact that the "WOLF" system for the online detection of "OFAC" related matches will not be implemented until April 06; and because neither USD demand deposit accounts nor the Credit Card systems yet provide online validation against the "OFAC" list for new account openings. Please note that once these systems are updated, all other products and services will also be controlled as they all require a cheque account to be operated.

Pending these systems changes, manual controls have been implemented in Private Banking, Treasury, Trade Services, and Trust; however, please note that no automated means exists to ensure that these controls are properly being carried out.

Our greatest exposure, and hence principal focus, is to the volume of business historically carried out by HBMX customers with Cuba in US dollars.

Regards

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HSBC OCC 8874358

Graham Thomson  
Head of Group Audit Mexico  
Tel (52) 55 5721 6236

Matthew J W KING/GGM INA GHQ/HGHQ/HSBC

Matthew J W KING/GGM INA  
GHQ/HGHQ/HSBC Sent by: Liz A TESTER  
04/10/2005 06:23

To: Jon WADDIS/HD GAA APH/HBAP/HSBC@HSBC, Mike R  
ALLSOP/HD GFA GHQ/HGHQ/HSBC@HSBC, Peter J BOLAND/HD  
GAMM/BME/HSBC@HSBC, Alain CADOU/HD/HBFR/HSBC@HSBC,  
Grace Y M LAM/HD/TA GHQ/HBAP/HSBC@HSBC, Vincent J  
Mancuso/HBUS/HSBC@HSBC, Ian MCILLAN/HBEU/HSBC@HSBC,  
John RAMSDEN-KNOWLES/HBBR/HSBC@HSBC, Graham  
THOMSON/HBMX/HSBC@HSBC cc: Subject Re: GCL 050047 -  
Compliance with Sanctions

Please see the attached. Can you please speak to your local CMP functions to ascertain the areas of highest risk. Please ensure that appropriate reference is included within your audit programmes and give due consideration to the associated risks when planning your audit work for 2006.

A copy of the HTV guidelines referred to follows by separate email.

Regards,

Matthew King

David W J BAGLEY/HGHQ/HSBC

David W J BAGLEY/HGHQ/HSBC HGHQ Sent To: Matthew J W KING/GGM INA GHQ/HGHQ/HSBC@HSBC cc: Subject  
by: Markon O ROACH 03/10/2005 15:43 Phone: GCL 050047 - Compliance with Sanctions Entity HSBC Holdings plc -  
No.: 7091 8645/44 2079 918645 Mail Size: HGHQ  
13949

Matthew

I refer to the above GCL, where the practical impact largely centres upon the OFAC sanctions, both at country and individual (SDN) level.

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HSBC OCC 8874359

Group CEO is particularly concerned to ensure as far as possible that the GCL is properly and fully implemented across the Group, recognising the significant US regulatory and reputational risks which might arise were even non-US Group members seen to infringe or aid and abet infringement of the OFAC sanctions. The recent case involving [REDACTED] perhaps provides a stark example of the potential consequences which arise in circumstances where the US authorities suspect involvement in "breach".

I attach a copy of my note to Stephen dated 19 September which sought to both update him with regard to certain significant steps required as part of implementation but also indicated that we would need to seek further assurance with regard to compliance with the GCL either by specific and targeted reviews (which will need to take place in the first quarter of 2006) and will be the subject of the Compliance planning process, but also presumably through relevant scrutiny as part of audits.

Areas particularly affected by the GCL would include Trade Finance (where HTB have issued specific guidance), Payments areas, Correspondent Banking and possibly participation in local USD settlement systems. I am happy to discuss relevant aspects of the GCL, and the practical issues which we have already seen arising out of implementation, with any of your team if you think this would help, and whilst I recognise that as a matter of routine your audit programmes consider GCLs, it is clear that Group CEO sees compliance with this GCL as being of particular significance.

Regards

David Bagley  
(sent not seen by DWJB)



Memo  
19 Sep 2005 15:29

From: David W J BAGLEY/HGHQ/HSBC

Tel: 7991 8845  
44 2079 918645  
Fax: 7 9020 1110

Sent by: Mark O ROACH

Stephen K GREEN et al

To: Stephen K GREEN/HSBH/MSB/MERIDIAN/HSBC  
cc: Richard E T BENNETT/HSBH/HSBC/HSBC  
bcc:

Redacted Material

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HSBC OCC 8874360



Subject: GCL050047 "COMPLIANCE WITH SANCTIONS"

Stephen

Given the significance of the above GCL, and conscious of the fact that I will miss the next pre-GMB meeting whilst in Hong Kong, I thought I should update you with progress made in relation to implementation of the GCL since its issue. The key points are:-

The required specialist "U-turn" team has been established in HBME DUB who have opened a correspondent account with J P Morgan Chase through which the pre-screened complaint U-turn Iranian Payments can be made.

A number of Group Offices have opened USD accounts with HBME (through which they will route all Iranian payments) I am not convinced that all Group Offices with Iranian payments are yet routing those payments through HBME, which the GCL required they should do by 1 SEP05. I have already issued a reminder to Regional Compliance Officers and asked that they review with their Business Heads if they do have relevant business which requires routing through HBME. It is of course entirely possible that some offices may have no need of these accounts if they have no relevant activity. I have asked for confirmations of the local position by close on 23 September.

GHQ CMP have provided, and continue to provide, significant levels of ad hoc advice in relation to OFAC sanctions, including in respect of activities within CBM. The latter consisted of FX and Bond dealing with Iranian banks. Where necessary we have validated our advice with external lawyers.

HTV, in close consultation with GHQ CMP have issued detailed guidance with regard to operational procedures for trade transactions involving Iran. Most of the payment flows linked to trade transactions we have considered to date are U-turn compliant. HTV's procedures are intended to ensure that no further trade commitments are entered into where the ultimate payments would be other than compliant. For operational reasons HTV have adopted an approach which is stricter than the requirements of the GCL.

I suspect that ASP is most heavily affected by the GCL, particularly in relation to trade by their customers with Myanmar. Whilst I am sure that there will have been some adverse reaction on activity involving Iran, most of the trade transactions have been able to continue as the payments are U-turn compliant. I have not received any feedback on the reaction within Iran.

I have indicated to the Compliance function globally that they will be required to carry out a comprehensive programme of reviews, against a standard template to be provided by GHQ CMP, to consider whether the GCL has been implemented. I will also discuss with Matthew King how we can use routine audits to provide additional comfort.

A recent meeting of the Wolfsberg Group confirmed both the substance and timeliness of the approach we have adopted. It appears that at least 3 European banks have OFAC related issues, although ABN are by far the worst affected. David Hodgkinson advised me that he has heard that the fine to be imposed on ABN may be as large as USD350m, although this is unconfirmed. Additionally Warren Leaming, RCO Dubai, has been called to a meeting with major banks at the US Consulate where they will be addressed by a representative from OFAC. I suspect this follows on from the known visit to ABN's Dubai Office by representatives from the Federal Reserve.

I will continue to monitor implementation of the GCL and at the Global Conference arranged in October

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HSBC OCC 8874361

will re-emphasise to the function the significance and the reasons for our policy, and the need to monitor Compliance. I wonder if it would also be appropriate for you to talk briefly about the significance of this GCL at the AOP offsite.

No questions or issues were raised in connection with cover payments during the peer review carried out jointly by FRB and OCC of our correspondent banking activities with HBUS.

I will be discussing how best to address the USD clearing system in Hong Kong, where HBAP act as the administering bank, during my visit next week. Any changes to this system which we think are advisable in the context of the OFAC sanction will need to be discussed with HKMA. Given that there are obvious potential sensitivities in being seen to apply US regulation extra-territorially I recognise the need to proceed with caution, whilst protecting us against US regulatory risk.

We have closed a number of USD correspondent relationships with Cuban and Myanmar banks.

We have, as anticipated within the GCL, allowed a number of pre-existing commitments to be honoured, but emphasised that no fresh arrangements should be entered into which would breach the terms of the GCL.

David Bagley

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HSBC OCC 8874362

## EXCERPT

HSBC

Deloitte LLP

### Transaction Review Progress and Results Reporting

18<sup>th</sup> & 19<sup>th</sup> October 2011

Permanent Subcommittee on Investigations  
EXHIBIT #71d

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HSBC-PSI-PROD-0096628

923

**Correspondent and other accounts - Summary of accounts subject to review by location and regime**

The table below summarises the number of all USD and non-USD accounts (containing USD transactions) with sanctioned banks or banks in sanctioned countries identified, split by the location of the account and the related sanctions regime.

Sanctions Regime*	UK		Hong Kong*	Total	
	USD	Non-USD	USD	USD	Non-USD
Burma	0	0	2	2	0
Cuba	7	0	0	7	0
Iran	11	11	1	12	11
Iraq	5	0	0	5	0
Libya	1	0	0	1	0
North Korea	2	0	0	2	0
Sudan	22	13	1	23	13
Syria	1	1	0	1	1
Taliban	2	0	0	2	0
Total	51	31	4	55	31

\* The Hong Kong reviews have not commenced and the overall number of accounts may change.

See Appendix 1 for listing of correspondent and other accounts for the UK (USD and Non-USD accounts) and for Hong Kong (USD accounts only)

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18<sup>th</sup> / 19<sup>th</sup> October 2011

22

Confidential Treatment Requested

HSBC-PSI-PROD-0096649

924

From: TERESA PESCE/HBUS/HSBC  
 Sent: 1/26/2005 11:01:12 AM  
 To: MICHAEL B GALLAGHER/HBUS/HSBC@HSBC; CHRISTOPHER LOK/HBUS/HSBC@HSBC; PETER G MERRITT/HBUS/HSBC@HSBC  
 CC: TONY MURPHY/HBUS/HSBC@HSBC; JOSEPH M PETRI/HBUS/HSBC@HSBC; CAROLYN M WIND/HBUS/HSBC@HSBC;  
 CAMILLUS P HUGHES/HBUS/HSBC@HSBC; ALAN T KETLEY/HBUS/HSBC@HSBC; WILLIAM M WONG/HBUS/HSBC@HSBC;  
 SUSAN A WRIGHT/HQ/HSBC@HSBC  
 Subject: Al Rahji Trading/Al Rahji Banking

All -

As some of you may know, the above named clients have been under evaluation by US and Group Compliance based, among other things, on relationships maintained with entities/countries on the OFAC list. Additionally, US law enforcement has placed these entities under scrutiny. After much consideration, Group Compliance has recommended that the US businesses sever ties with these clients based on the current regulatory environment and the interest of US law enforcement. Accordingly, I will not approve customer profiles for or transactions with these entities. Please make appropriate arrangements. I am available to answer any questions you might have.

Regards-  
 Terry

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 Confidential - FOIA Treatment Requested

Permanent Subcommittee on Investigations  
 EXHIBIT #72

s, Inc. HSB02269091  
 HSBC OCC 1884218

From: ALAN T KETLEY/HBUS/HSBC  
 Sent: 3/16/2005 4:45:02 PM  
 To: PAUL PLESSER/HBUS/HSBC@HSBC  
 CC:  
 Subject: Fw: Al Rahji Guidance Clarified

Paul

Looks like you're fine to continue dealing with Al Rahji.

You'd better be making lots of money!

Alan

----- Forwarded by Alan T Ketley/HBUS/HSBC on 03/16/2005 04:43

PM

Teresa Pesce on 10 Mar 2005 12:26

Note

10 Mar 2005 12:26

From: Teresa Pesce Tel: 212-525-6099  
 Title: Executive Vice President Location: 452 5th Ave, Floor 07  
 WorkGroup: COMP/ANTI-MONEY LAUNDERING Mail Size: 1931

To: Chris P DAVIES/HBUS/HSBC@HSBC  
 Christopher Lok/HBUS/HSBC@HSBC  
 Michael B Gallagher/HBUS/HSBC@HSBC  
 Alan T Ketley/HBUS/HSBC@HSBC

Subject: Al Rahji Guidance Clarified

Group has clarified the Al Rahji guidance issued last month. They have evaluated Al Rahji Banking and Al Rahji Trading and now believe that the two are separated enough that relationships may be maintained with the latter but not with the former. To be clear, recommendation is to sever with Banking only at this time.

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 Confidential - FOIA Treatment Request

Permanent Subcommittee on Investigations  
**EXHIBIT #73**

, Inc. HSB03499664  
 HSBC OCC 3114022

Occ-Psi-00144350  
 From: CHRISTOPHER LOK/HBUS/HSBC  
 Sent: 5/23/2005 10:28:51 AM  
 To: TERESA PESCE/HBUS/HSBC@HSBC  
 CC: STEPHEN J ALLEN/HBMD/HSBCMERIDIAN@HSBCMERIDIAN  
 Subject: Fw: Al Rajhi

Terri

After the OCC close out and that chapter hopefully finshed, could we re-visit Al Rajhi again. London compliance has taken a more lenient view, as per below.

Chris

----- Forwarded by Christopher Lok/HBUS/HSBC on 05/23/2005

11:29 AM -----  
 Stephen J ALLEN on 23 May 2005 10:46

Memo  
 23 May 2005 10:46

From: Stephen J ALLEN Tel: 7992 4555  
 44 2079 92 4555  
 Title: Location:  
 WorkGroup: Mail Size: 759510

To: Christopher Lok/HBUS/HSBC@HSBCAMERICAS

Subject: Al Rajhi

Chris,

Here's the rest;

Steve

----- Forwarded by Stephen J ALLEN/HBMD/HSBCMERIDIAN on 23 May 2005 15:45 -----  
 Stephen J ALLEN/HBMD/HSBCMERIDIAN on 23 May 2005 15:20

Memo  
 23 May 2005 15:20

From: Stephen J ALLEN/HBMD/HSBCMERIDIAN Tel: 7992 4555  
 44 2079 92 4555  
 Mail Size: 5101

To: Christopher Lok/HBUS/HSBC@HSBCAMERICAS

cc:  
 bcc:

Subject:

Chris,

we'll have to see if this will make any difference! I haven't seen the new kyc yet but, we are getting a copy.

Steve

928

Occ-Psi-00144350

David W J BAGLEY  
HGHO  
23 May 2005 16:03  
;7991 8645;44 2079 918645  
Sent by: Marion O ROACH

To: David H HODGKINSON/DCH MEM/HBME/HSBC@HSBC  
cc: Iqbal KHAN/CEO ISF HFSM/HBME/HSBC@HSBC  
Warren G LEAMING/RLA LGA MEM/HBME/HSBC@HSBC  
Susan A WRIGHT/HGHO/HSBC@HSBC  
Subject: AL RAJHI BANK  
Our Ref:  
Your Ref:  
Entity: HSBC Holdings plc - HGHO

David

Having now received the updated KYC from Shariq Siddiqui and reviewed the previous information received from Group Securities I am pleased to confirm that we have revised our recommendation in relation to the above.

Accordingly we have lifted our recommendation against the commence or expansion of relationships with the above with immediate effect. We will communicate this decision to HBEU where I believe there are a number of pending applications.

Whilst we will advise HBUS CMP of the revised view within GHQ CMP nevertheless I believe it will remain appropriate for HBUS CMP in conjunction with HBUS senior management to reach their own determination with regard to the expansion of business with Al Rajhi within the US. Although the revised view from GHQ CMP ought to be a material matter causing them to reconsider their position nonetheless, and particularly in the current US environment, I do not believe it is appropriate for us to seek to influence their determination one way or the other. This was something that I discussed as a possible outcome with Iqbal when we discussed Al Rajhi.

Regards

David Bagley

Attachment: Al Rajhi HBME kyc 05.05.PDF  
Attachment: Al Rajhi Article 05.05.pdf

Page 2



OCC-PSI-00343527

## SOME EMAILS FROM ICRO ELECTRONIC FILES PERTAINING TO AL RAJHI

## Note

10 Aug 2005 12:12

From: Teresa Pesce Tel: 212-525-6099

Title: Executive Vice President Location: 452 5th Ave, Floor 07

WorkGroup: COMP/ANTI-MONEY LAUNDERING Mail Size: 777381

To: Sally G LOMAS/HBMD/HSBCMERIDIAN@HSBC

cc: Lynda J Cassell/HBUS/HSBC@HSBC; Anne Liddy/HBUS/HSBC@HSBC; Alan T Ketley/HBUS/HSBC@HSBC; Gloria Strazza/HBUS/HSBC@HSBC; Stephen J ALLEN/HBMD/HSBCMERIDIAN@HSBC; Susan SALAS/IBEU/HSBC@HSBC

Subject: Re: Fw: Al Rajhi

Sally -

This is not so simple. David does not object insofar as HBEU is concerned, but has left it to us to assess the US risk. We've gotten push back from the OCC on Al Rajhi Trading, which is less controversial than the bank. We can revisit this, but I am not inclined to push ahead precipitously, especially in light of the regulatory scrutiny.

Regards-

Terry

Sally G LOMAS on 10 Aug 2005 09:59

Memo 10 Aug 2005 09:59

From: Sally G LOMAS Tel: 799 11511

44 2079 911511

Title: Location:

WorkGroup: Mail Size: 773184

To: Lynda J Cassell/HBUS/HSBC@HSBC

cc: Teresa Pesce/HBUS/HSBC@HSBC

Anne Liddy/HBUS/HSBC@HSBC

Alan T Ketley/HBUS/HSBC@HSBC

Gloria Strazza/HBUS/HSBC@HSBC

Stephen J ALLEN/HBMD/HSBCMERIDIAN@HSBC

Susan SALAS/IBEU/HSBC@HSBC

Subject: Fw: Al Rajhi

Lynda,

please find attached an email sent by David Bagley, indicating that there is no longer a recommendation against expanding relationships with Al Rajhi Bank.

1

Permanent Subcommittee on Investigations

EXHIBIT #75

OCC-PSI-00343527

I have asked Fig to check, when they do their additional work, whether the same part of the Al Rajhi family is involved in both Banks. We now need to wait until we have the more detailed EIDD information which you have requested,

Regards

Sally

- Forwarded by Sally G LOMAS/HBMD/HSBCMERIDIAN on 10 Aug 2005 14:52 -  
Stephen J ALLEN/HBMD/HSBCMERIDIAN on 10 Aug 2005 10:17  
From: Stephen J ALLEN/HBMD/HSBCMERIDIAN Tel: 7992 4555  
44 2079 92 4555  
Mail Size: 767532

To: Sally G LOMAS/HBMD/HSBCMERIDIAN@HSBC

cc:

bcc:

Subject: Fw: Al Rajhi

- Forwarded by Stephen J ALLEN/HBMD/HSBCMERIDIAN on 10 Aug 2005 10:17 -  
Christopher Lok/HBUS/HSBC on 23 May 2005 16:28  
From: Christopher Lok/HBUS/HSBC Tel: 212-525-2062  
Mail Size: 761889

To: Teresa Pesce/HBUS/HSBC@HSBC

cc: Stephen J ALLEN/HBMD/HSBCMERIDIAN@HSBCMERIDIAN

bcc:

Subject: Fw: Al Rajhi

Terri

After the OCC close out and that chapter hopefully finished, could we re-visit Al Rajhi again. London compliance has taken a more lenient view, as per below.

Chris

-----  
David W J BAGLEY  
HGHQ  
23 May 2005 16:03  
7991 8645;44 2079 918645  
Sent by: Marion O ROACH

To: David H HODGKINSON/DCH MEM/HBME/HSBC@HSBC

cc: Iqbal KHAN/CEO ISF HFSM/HBME/HSBC@HSBC

Warren G LEAMING/RLA LGA MEM/HBME/HSBC@HSBC

OCC-PSI-00343527

Susan A WRIGHT/HGHQ/HSBC@HSBC  
 Subject: AL RAJHI BANK  
 Our Ref:  
 Your Ref:  
 Entity: HSBC Holdings plc - HGHQ

David

Having now received the updated KYC from Shariq Siddiqui and reviewed the previous information received from Group Securities I am pleased to confirm that we have revised our recommendation in relation to the above.

Accordingly we have lifted our recommendation against the commence or expansion of relationships with the above with immediate effect. We will communicate this decision to HBEU where I believe there are a number of pending applications.

Whilst we will advise HBUS CMP of the revised view within GHQ CMP nevertheless I believe it will remain appropriate for HBUS CMP in conjunction with HBUS senior management to reach their own determination with regard to the expansion of business with Al Rajhi within the US. Although the revised view from GHQ CMP ought to be a material matter causing them to reconsider their position nonetheless, and particularly in the current US environment, I do not believe it is appropriate for us to seek to influence their determination one way or the other. This was something that I discussed as a possible outcome with Iqbal when we discussed Al Rajhi.

Regards

David Bagley

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Permanent Subcommittee on Investigations  
EXHIBIT #76  
; Inc. HSB05750412  
HSBC OCC 5364770

	A	B	C	D	E	F
1	HBUS GLOBAL BANKNOTES - Purchases & Sales of USD					
2						
3	Summary by Country: 2008 vs 2009			All figures are in USD thousands.		
4	(excluding HSBC Group affiliates, FRB & US Depts)					
5	COUNTRY	Risk	Trades by HSBC	8-Month Total: ending Mar-08	8-Month Total: ending Mar-09	CHANGE: 2008-2009
6	azerbaian	High	Purchases	\$5,260	\$5,000	-5%
7	bangladesh	High	Purchases	\$8,240	\$30	-100%
8	belarus	High	Purchases	\$113,864	\$79,063	-31%
9	camodia	High	Purchases	\$278,072	\$554,047	99%
10						
11	colombia	High	Purchases	\$10,677	\$24,636	133%
12	congo dem rep of	High	Purchases	\$12,000	\$67,008	376%
13	ethiopia	High	Purchases	\$64,921	\$74,333	14%
14	georgia	High	Purchases	\$26,090	\$9,618	-64%
15	haiti	High	Purchases	\$72,022	\$62,028	-28%
16	indonesia	High	Purchases	\$311,686	\$347,969	12%
17	kazakhstan	High	Purchases	\$37,667	\$13,073	-66%
18	kenya	High	Purchases	\$67,988	\$142,646	110%
19	kyrgyzstan	High	Purchases	\$19,600	\$88,600	352%
20	latvia	High	Purchases	\$0	\$5,000	#DIV/0!
21	macau	High	Purchases	\$77,366	\$32,322	-58%
22	mexico	High	Purchases	\$74,201	\$50,297	-32%
23	mongolia	High	Purchases	\$1,636,530	\$1,937,386	18%
24	nepal	High	Purchases	\$4,364	\$24,598	464%
25	nicaragua	High	Purchases	\$9,436	\$20,128	135%
26	pakistan	High	Purchases	\$167,260	\$160,266	2%
27	philippines	High	Purchases	\$46,788	\$18,462	-67%
28	ruanda	High	Purchases	\$1,282,621	\$1,424,896	11%

A		D
1	HBUS GLOBAL BANKNOTES - Purchases & Sales of USD	
2		
3	Details by Customer within Country: 2008 vs 2009	SCC/CNB/ New CLIENT
4	(excluding HSBC Group affiliates, FRB & US Depts)	SCC
5	COUNTRY	
6	ANGOLA	
7	ANGOLA	
	ANGOLA	
8		
9	ANGOLA	SCC
	ANGOLA	
10		
11	ANGOLA	SCC
12	ANGOLA	New client: Jun-08
13	ANGOLA	
14	ANGOLA	New client: Nov-08
15	AZERBAIJAN	New client: Nov-08
16	AZERBAIJAN	New client: Jan-08
17	AZERBAIJAN	
18		
19	AZERBAIJAN	
20	AZERBAIJAN	CNB
21	AZERBAIJAN	New client: Nov-08
22	BANGLADESH	
23	BANGLADESH	
24	BANGLADESH	
	BELARUS	
25		
26	BELARUS	SCC
27	BELARUS	SCC/CNB
	BELARUS	
28		
29	BELARUS	SCC/CNB

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Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 5364784

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Permanent Subcommittee on Investigations

	MEXICO	High	BANCO MERCANTIL DEL NORTE	
111				
112	MEXICO	High	BANCO MERCANTIL DEL NORTE	
	MEXICO	High	BANCO NACIONAL DE MEXICO	
113				
114	MEXICO	High	BANCO NACIONAL DE MEXICO	
115	MEXICO	High	BBVA BANCOMER SA	
116	MEXICO	High	BBVA BANCOMER SA	
117	MEXICO	High	CONSULTORIA INTERNACIONL BANCO	SCC
118	MEXICO	High	CONSULTORIA INTERNACIONL BANCO	SCC
119	MEXICO	High	INTERCAM CASA DE BOLSA	SCC
120	MEXICO	High	INTERCAM CASA DE BOLSA	SCC
121	MEXICO	High	IXE BANCO SA	
122	MEXICO	High	IXE BANCO SA	

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Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 5364793

Redacted by the  
Permanent Subcommittee on Investigations

	Purchases	\$95,671	\$161,945	59%	NEW YORK	Increase & high \$ volume
111						
112	Sales	\$14,600	\$60	-100%	NEW YORK	
	Purchases	\$850,841	\$1,377,917	62%	NEW YORK	Increase & high \$ volume
113						
114	Sales	\$8,997	\$64	-99%	NEW YORK	
115	Purchases	\$413,393	\$0	-100%	NEW YORK	
116	Sales	\$11,213	\$0	-100%	NEW YORK	
117	Purchases	\$247,743	\$302,933	22%	NEW YORK	
118	Sales	\$8,600	\$4,500	-49%	NEW YORK	
119	Purchases	\$17,040	\$50,076	199%	NEW YORK	Increase
120	Sales	\$24,000	\$6,691	-73%	NEW YORK	
121	Purchases	\$20,842	\$45,714	110%	NEW YORK	Increase
122	Sales	\$4,000	\$0	-100%	NEW YORK	

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Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 5364794

11/17/2006 08:53 AM

To  
Beth Fisher/HBUS/HSBC@HSBCAMERICAS, Alan T Ketley/HBUS/HSBC@HSBC  
cc  
Subject  
Al Rajhi Banking

Beth/Alan,

Salman Hussain, the PCM Regional Sales Manager at HBME in Bahrain, who has recently visited the subject, has called to say that Al Rajhi has now run out of patience waiting for us to re-start our banknote trading relationship and unless we can complete the kyc formalities and advise them accordingly by the end of November, they will terminate all product relationships with the HSBC Group - which I believe to be substantial.

Their main point of contention is that they feel that they were exonerated by all US legal processes from TF suspicion some time ago and yet we have still not been able to re-start trading with them. Gordon finished our latest attempt at the profile on Tuesday and you will find the kyc profile to be currently in the '1B Pending' inbox. Could I please ask you both to expedite your reviews so that we can attempt to prevent the loss of an important client to the Group?

thanks and regards  
Steve

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Confidential - FOIA Treatment Request

Permanent Subcommittee on Investigations  
**EXHIBIT #77**

, Inc. HSB03666147  
HSBC OCC 3280505



Occ-Ps1-00150795  
 From: CHRISTOPHER LOK/HBUS/HSBC  
 Sent: 11/17/2006 10:05:55 AM  
 To: STEPHEN J ALLEN/HBMD/HSBCMERIDIAN@HSBCMERIDIAN  
 CC: DAVID M WILENS/HBUS/HSBC@HSBC  
 Subject: Re: Fw: Al Rajhi Banking

Steve

At the end of the day, its Compliance who's the key. I'll speak to Ketley & ask him to re-evaluate this name.

Chris

Stephen J ALLEN/HBMD/HSBCMERIDIAN  
 Tel: 799 24555; +44 (0) 20 7992 4555  
 11/17/2006 09:34 AM

To  
 Christopher Lok/HBUS/HSBC@HSBC  
 CC  
 David M Wilens/HBUS/HSBC@HSBC  
 Subject  
 Fw: Al Rajhi Banking

Chris,

who do you suggest can/will sign this profile?

You will see that it is pressing - perhaps David could IS and you could IB approve if Susan and I sign it again?.

Steve

----- Forwarded by Stephen J ALLEN/HBMD/HSBCMERIDIAN on 17/11/2006 14:30 -----

Beth Fisher/HBUS/HSBC  
 HBUS  
 17/11/2006 14:23  
 Mail Size: 7422

To  
 Stephen J ALLEN/HBMD/HSBCMERIDIAN@HSBC  
 CC  
 Alan T Ketley/HBUS/HSBC@HSBC, Christopher J Heusler/HBUS/HSBC@HSBC  
 Subject  
 Re: Al Rajhi Banking  
 Entity  
 HSBC Bank USA, London Branch (Treasury and Capital Markets - TCM)

Steve,

Page 1

Permanent Subcommittee on Investigations  
 EXHIBIT #78

Occ-Psi-00150795

I am not trying to be difficult, but I do not personally feel comfortable IB approving this name. I do not know this bank. Additionally, several years ago, when HBUS had relationships with 2 different Al Rajhi names, management would ask me questions about the customer every time the name appeared in the US newspapers. I do not know this bank personally and am therefore not qualified to render an opinion; I cannot answer questions if/when the Alrajhi name appears in US news media.

Therefore, please ask another officer to IB approve. I am IB-Denied the KYC, so that my name can be removed as RM.

Thank you.

Beth

Stephen J ALLEN/HBMD/HSBCMERIDIAN  
Tel: 799 24555; +44 (0) 20 7992 4555  
11/17/2006 08:53 AM

To  
Beth Fisher/HBUS/HSBC@HSBCAMERICAS, Alan T Ketley/HBUS/HSBC@HSBC  
cc

Subject  
Al Rajhi Banking

Beth/Alan,

Salman Hussain, the PCM Regional Sales Manager at HBME in Bahrain, who has recently visited the subject, has called to say that Al Rajhi has now run out of patience waiting for us to re-start our banknote trading relationship and unless we can complete the kyc formalities and advise them accordingly by the end of November, they will terminate all product relationships with the HSBC Group - which I believe to be substantial.

Their main point of contention is that they feel that they were exonerated by all US legal processes from TF suspicion some time ago and yet we have still not been able to re-start trading with them. Gordon finished our latest attempt at the profile on Tuesday and you will find the kyc profile to be currently in the 'IB Pending' inbox. Could I please ask you both to expedite your reviews so that we can attempt to prevent the loss of an important client to the Group?

thanks and regards  
Steve

Occ-Psi-00150798  
 From: CHRISTOPHER LOK/HBUS/HSBC  
 Sent: 11/17/2006 10:31:07 AM  
 To: STEPHEN J ALLEN/HBMD/HSBCMERIDIAN@HSBCMERIDIAN  
 CC:  
 Subject: Re: Alrajhi

I would tell Salman that he should relay the 'concern' Alrajhi has expressed to the higher ups. To cancel the Amanah business is much bigger than not dealing with banknotes. Hopefully somebody in London will listen and given NYK Compliance a gentle push.

Chris

Stephen J ALLEN/HBMD/HSBCMERIDIAN  
 Tel: 799 24555; +44 (0) 20 7992 4555  
 11/17/2006 10:20 AM

To  
 Christopher Lok/HBUS/HSBC@HSBC  
 CC  
 Subject  
 Re: Alrajhi

Chris,

This is the note that I received subsequent to Salman calling (I sent it on to Alan)

As ever, we are taking an inordinate amount of time to make our minds up.

I discussed this client with Terry, Linda and Alan when I visited in February, we eventually received and have now answered a raft of supplementary questions from Linda and now that she has left, no doubt there will be more questions from Alan!

Steve

Salman HUSSAIN/HBME/HSBC  
 HBME  
 17/11/2006 13:56  
 Phone No. 0097317569599  
 Mail Size: 16093

To  
 David B ILLING/HBMD/HSBCMERIDIAN, Gordon BROWN/IBEU/HSBC, Stephen J ALLEN/HBMD/HSBCMERIDIAN@HSBC  
 CC  
 Ciara O'CONNELL/IBEU/HSBC, Shariq Z SIDDIQI/HBME/HSBC, John L SCOTT/HBEU/HSBC,  
 Hammad Zaidi/HBUS/HSBC, Stephen D Loffredo/HBUS/HSBC@HSBC  
 Subject  
 Fw: Al Rajhi Bank KYC & AML Policy  
 Entity  
 HSBC Bank Middle East Limited

Page 1

Permanent Subcommittee on Investigations  
**EXHIBIT #79**

Occ-Psi-00150798

Dear David, Gordon and Stephen,

Further to my phone call with David last week after meeting Al Rajhi Bank in Riyadh, I was given a deadline by Mr. Cassim Docrat, Head of FI until end of Nov. to respond to them whether we will be able to resume the banknote business or not. Mr. Docrat indicated that HSBC Amanah business will be at risk and they will cancel any dealings with HSBC.

Mr. Docrat understand Compliance Dept. requirements and suggested we request further information from Moody (Attn. Mr. Anwar Hasson) or S&P. He also indicated that JP Morgan Chase, their main US\$ clearer had done the same and accordingly an O/D limit of \$290mm established by JPMC for Al Rajhi.

I can't stress on the fact that we do want to do business with this institution from PCM side. We do stand a good chance to win a US\$ clearing account thru offering Islamic Overnight Investment Product and the US\$ check clearing thru Check 21.

Kindly let me know if you do require any further assistance to obtain compliance approval.

Best regards,

Salman Hussain  
Regional Sales Manager  
Global Transaction Banking

Christopher Lok/HBUS/HSBC  
HBUS  
17/11/2006 15:11  
Mail Size: 2435

To: Stephen J ALLEN/HBMD/HSBCMERIDIAN@HSBCMERIDIAN  
cc  
Subject: Alrajhi  
Entity  
HSBC Bank USA, London Branch (Treasury and Capital Markets - TCM)

Steve

Just spoke to Alan. He's going to read the whole file, including the few EDD. He says the file is more than an inch thick and he's aware of the 'threat' you passed along. His view is Alrajhi may not really walk away if we can't revert by November end, which I agree.

Page 2

941

Occ-Psi-00150798

I told him frankly lets avoid the middlemen and go straight to the decision maker. WE should have an answer in the next few weeks.

Chris

Page 3

Occ-Psi-00150892

From: ALAN T KETLEY/HBUS/HSBC  
 Sent: 12/1/2006 10:13:20 AM  
 To: STEPHEN J ALLEN/HBMD/HSBCMERIDIAN@HSBC; SALMAN HUSSAIN/HBME/HSBC@HSBC  
 CC: TERESA PESCE/HBUS/HSBC@HSBC; CHRISTOPHER LOK/HBUS/HSBC@HSBC  
 Subject: Al Rajhi Bank

Steve, Salman

The purpose of this note is to confirm to you the willingness of HBUS to recommence a relationship with Al Rajhi Bank.

I have reviewed Al Rajhi Bank's AML information as well as all the investigative research that has been performed by ICRO. I have also conducted some of my own research and am satisfied that we can do business with this entity as long as our due diligence is thoroughly documented and close transaction monitoring takes place by Compliance along with a high degree of transaction awareness being maintained by the business. Over a period of years there has been much negative publicity associated with the principals of this entity - while none of these allegations has been proven or substantiated, the notion of 'no smoke without fire' is one we must bear in mind and any business unit dealing with this entity must acknowledge the associated risks. I have not yet reviewed their Lotus Notes KYC Profile in any great detail but will try to do so before close of business today - to paraphrase an expression from English Banking, if it is in my hands and in order I will approve it.

I am confident that our Banknotes transaction monitoring is sufficiently robust to keep a close eye on this client's activities and I would ask that your traders apply special vigilance when dealing with them.

I'm addressing Salman with this note because I know that he too is looking to further develop the Al Rajhi Bank relationship but here I have to place some conditions. While we have a robust method of monitoring wire payment activity, we do not have a corresponding automated method of monitoring check or cash letter transactions. Accordingly, while I would be happy to see wire activity flowing over a future Al Rajhi Bank account, I cannot support paper activity with the degree of close monitoring that would be appropriate.

Chris Lok has agreed to act as relationship owner for this name in place of Beth Fisher - he will thus review and approve the profile if he is satisfied with it. Should a PCM relationship develop, it must be with the explicit approval of HBUS' senior PCM management.

Alan T. Ketley  
 Senior Vice President, Anti Money Laundering  
 Tel: 212 525 6147 / Fax: 212 382 7580

Page 1

Permanent Subcommittee on Investigations  
**EXHIBIT #80**

From: DANIEL JACK/HBUS/HSBC  
 Sent: 7/26/2007 1:55:33 PM  
 To: STEPHEN J ALLEN/HBMD/HSBCMERIDIAN@HSBC; GORDON BROWN/BEU/HSBC@HSBC  
 CC:  
 Subject: Al Rajhi Bank in Saudi Arabia

Steve / Gordon -

This article on Al Rajhi Bank & TF was in the Wall Street Journal today.

We realize that we re-activated the relationship with them last month.

We in AML-NY will draft a reply to Joe Boss & OCC soon.

Please review this below & let me know if you have any comments.

Thanks and regards,

Daniel Jack  
 VP - AML Compliance | HSBC Bank USA, NA  
 452 Fifth Avenue, 7th floor, New York, NY 10018

Phone. 212-525-8686  
 Email. daniel.jack@us.hsbc.com

----- Forwarded by Daniel Jack/HBUS/HSBC on 07/26/2007 02:48 PM -----

----- Forwarded by Alan T Ketley/HBUS/HSBC on 07/26/2007 08:30 AM -----

"Boss, Joseph" <Joseph.Boss@occ.treas.gov>  
 07/26/2007 08:24 AM

To  
 alan.t.ketley@us.hsbc.com  
 cc  
 "Boss, Joseph" <Joseph.Boss@occ.treas.gov>  
 Subject  
 Saudi's

Alan, for your information and review. Please let me know if there is anything. This appeared on the front page of today's Wall Street Journal.  
 Thanks, Joe  
 TERROR FINANCE  
 U.S. Tracks Saudi Bank Favored by Extremists

Permanent Subcommittee on Investigations

EXHIBIT #81

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s, Inc. HSB03216516  
 HSBC OCC 2830874

Officials Debated What To Do About Al Rajhi, Intelligence Files Show  
 By GLENN R. SIMPSON  
 July 26, 2007; Page A1

JIDDA, Saudi Arabia -- In the 1940s, two Bedouin farm boys from the desert began changing money for the trickle of traders and religious pilgrims in this then-remote and barren kingdom. It was a business built on faith and trust, Sulaiman Al Rajhi once told an interviewer, and for many years he would hand gold bars to strangers boarding flights in Jidda and ask them to give the gold to his brother on their arrival in Riyadh.

#### EXTREMISTS' ACCOUNTS

The News: U.S. intelligence reports say Islamic extremists often use Saudi Arabia's Al Rajhi Bank to move money. The bank has denounced terrorism and denies any role in financing extremists.

The Issue: A confrontation with Al Rajhi would be politically difficult for Saudi monarchy, and U.S. isn't satisfied with its efforts to curb the financial infrastructure essential to terrorism.

Result: U.S. has periodically debated taking action on its own against the bank, but chosen instead to lobby the Saudis quietly about its concerns. Today, Mr. Al Rajhi is a reclusive octogenarian whose fortune is estimated at \$12 billion. And Al Rajhi Bank grew into the kingdom's largest Islamic bank, with 500 branches in Saudi Arabia and more spread across the Muslim world. Following the Sept. 11, 2001, attacks, the bank also set off an intense debate within the U.S. government over whether to take strong action against its alleged role in extremist finance. Confidential reports by the Central Intelligence Agency and other U.S. agencies, reviewed by The Wall Street Journal, detail for the first time how much the U.S. learned about the use of Al Rajhi Bank by alleged extremists, and how U.S. officials agonized over what to do about it.

After 9/11, the Saudi monarchy pledged its full support in the fight against global terrorism. And following violent attacks inside the kingdom in the next two years, the Saudis did launch major strikes against militants operating on their soil. But the Saudi government has been far less willing to tackle the financial infrastructure essential to terrorism. U.S. intelligence reports state that Islamic banks, while mostly doing ordinary commerce, also are institutions that extremism relies upon in its global spread. As a result, the Bush administration repeatedly debated proposals for taking strong action itself against Al Rajhi Bank, in particular, according to former U.S. officials and previously undisclosed government documents. Ultimately, the U.S. always chose instead to lobby Saudi officialdom quietly about its concerns.

The U.S. intelligence reports, heretofore secret, describe how Al Rajhi Bank has maintained accounts and accepted donations for Saudi charities that the U.S. and other nations have formally designated as fronts for al Qaeda or other terrorist groups.

In addition, Mr. Al Rajhi and family members have been major donors to Islamic charities that are suspected by Western intelligence agencies of funding terrorism, according to CIA reports and federal-court filings by the Justice Department.

A 2003 CIA report claims that a year after Sept. 11, with a spotlight on Islamic charities, Mr. Al Rajhi ordered Al Rajhi Bank's board "to explore financial instruments that would allow the bank's charitable contributions to avoid official Saudi scrutiny."

A few weeks earlier, the report says, Mr. Al Rajhi "transferred \$1.1 billion to offshore accounts -- using commodity swaps and two Lebanese banks -- citing a concern that U.S. and Saudi authorities might freeze his assets." The report was titled "Al Rajhi Bank: Conduit for Extremist Finance."

Al Rajhi Bank and the Al Rajhi family deny any role in financing extremists. They have denounced terrorist acts as un-Islamic. The bank declined to address

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specific allegations made in American intelligence and law-enforcement records, citing client confidentiality.  
RELATED DOCUMENTS

Al-Rajhi bank became a target for U.S. terrorism sanctions less than two months after Sept. 11, 2001.

No action was taken, but in mid-2003, the Central Intelligence Agency concluded that the Al-Rajhi family and their bank were financing terrorists, probably knowingly. This is the summary page<sup>1</sup> from the agency's report.

The bank sued The Wall Street Journal Europe for libel in 2002 over a report that it was under scrutiny in connection with terrorism funding, but dropped the case in 2004 and The Wall Street Journal published the bank's statement<sup>2</sup>. The CIA's report and other U.S. intelligence on Al-Rajhi remained secret, and in 2005 a federal judge threw out a lawsuit against the bank by victims of Al Qaeda, saying there was no evidence Al-Rajhi provided anything but routine banking services to terrorists. Read the order.<sup>3</sup>

The Al-Rajhi family and the ruling Al-Saud family of Saudi Arabia have been at odds for decades, in part because of the accidental death of an infant Al-Rajhi family member in a botched police rescue attempt during a kidnapping. Saudi dissidents in London issued a communiqué recounting the incident<sup>4</sup> that was highly critical of Saudi authorities. The document was made available by the Investigative Project on Terrorism, a Washington-based nonprofit group. This 1992 State Department cable<sup>5</sup> from the U.S. ambassador in Riyadh discusses the Saudi press coverage of the Al Rajhi bank's purported role in the BCCI scandal.

One of the Al Rajhi bank's major longtime clients is the International Islamic Relief Organization of Jeddah, Saudi Arabia, a powerful charity backed by some of the country's wealthiest businessmen. This fundraising solicitation<sup>6</sup> is from the IIRO's March 2007 newsletter. The group strongly denounces terrorism on its Web site.<sup>7</sup>

U.S. intelligence has alleged connections between al Qaeda and the IIRO since 1996, and the Treasury Department now alleges<sup>8</sup> the IIRO has been deeply penetrated by al Qaeda. The group denies supporting terrorism in this statement<sup>9</sup> from its most recent newsletter. The group also claims it no longer sends money overseas, and that its accounts are frozen by Saudi banks. Yet its most recent fundraising letter<sup>10</sup> solicits donations to Al Rajhi bank and touts a variety of ongoing projects in overseas conflict zones.

In 2004, IIRO funded a medical facility in Fallujah while that central Iraqi town was under the control of Iraqi insurgents. The U.S. Marine Corps blew up the clinic, and says all three of the city's hospitals were being used by insurgents as fighting positions. See the PowerPoint slides<sup>11</sup>.

In 2002, the bank sued The Wall Street Journal Europe after an article said Saudi authorities were monitoring some Al Rajhi Bank accounts at U.S. request, in a bid to prevent them from being used, wittingly or unwittingly, for funneling money to terrorist groups. The bank dropped the suit in 2005 and the Journal published a statement saying its article hadn't reported any allegation that the bank supported or financed terrorism.

Also in 2005, a U.S. judge dismissed Al Rajhi Bank from a lawsuit filed by relatives of Sept. 11 victims. The ruling said banks couldn't be held liable for providing routine services to people who turned out to be terrorists. In a statement in response to questions about suspected terrorists among its clients, the bank noted that "Al Rajhi Bank has a very large branch network, and a very large retail customer base."

U.S. law-enforcement and intelligence agencies acknowledge it is possible that extremists use the bank's far-flung branches and money-transfer services without bank officials' knowledge. The U.S. has never obtained proof that the bank or its owners knowingly facilitate terrorism, according to documents and former officials, despite what they describe as extensive circumstantial evidence that some executives are aware the bank is used by extremists. The

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Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 2830876

2003 CIA report concluded: "Senior Al Rajhi family members have long supported Islamic extremists and probably know that terrorists use their bank."

Most major banks around the world are bound by a patchwork of treaties and agreements that, in effect, require them to know their customers and report any suspicious activities to regulators. The rules are designed to fight terrorism, money laundering and narcotics trafficking. It's generally acknowledged that Saudi banks are bound by these rules, although experts differ on when compliance became mandatory.

The top counterterrorism official at the U.S. Treasury Department, while declining to comment on Al Rajhi Bank specifically, says Saudi officials haven't met a promise to create a commission to oversee Saudi charities, many of which bank with Al Rajhi. "They are also not holding people responsible for sending money abroad for jihad," says the Treasury official, Stuart Levey. "It just doesn't happen."

The Saudi government maintains it has been working diligently with the U.S. and others to counter terrorism. It cites its arrests of several alleged terrorist fund-raisers in recent years. The Saudis didn't respond to specific questions about their efforts to counter terrorist finance or oversee banks.

A White House statement said that "the Saudis continue to be a strong partner in the War on Terror...We have made significant progress on numerous fronts -- including the freezing of assets and the shutdown of known conduits of [terrorist] funding." A CIA spokesman said "publishing details of how our government seeks to track extremist financing" could undermine those efforts.

For the ruling Saud family, any confrontation with the Al Rajhis could be politically treacherous. To stay in power, the Saudis rely on the tolerance of clerical and business elites, many of whom view the royal family as corrupt. The wealthy Al Rajhis are a clan long at odds with the royal family. And U.S. intelligence files show the Al Rajhis also have close ties to another group critical of the royals: Saudi Arabia's conservative clerics.

The Al Rajhi empire includes hotels, housing developments, commodities trading, shipping, aviation leasing and poultry. Its core is the bank, with more than 500 branches in Saudi Arabia and other offices abroad, from Pakistan to Malaysia. For 2006, the publicly held institution reported \$1.9 billion in profit and \$28 billion in assets.

Sulaiman Al Rajhi grew up in the Nejd desert, the birthplace of a severe form of Islam, called Wahhabism, that forbids birthday parties, musical instruments and photographing people. In the 1940s, he and a brother, Saleh, went to the Saudi capital city. "From literally nothing -- making change on what were then the dirt streets of Riyadh -- Sulaiman and Saleh al Rajhi built the Al Rajhi Bank," Sulaiman's lawyers told a U.S. court in New York in 2005.

Sulaiman described the business in a rare interview with Euromoney magazine in 1983. With two other brothers, he and Saleh began changing money for pilgrims taking camel caravans across the desert to the holy cities of Mecca and Medina.

When throngs of migrant workers came to Saudi Arabia during the 1970s oil boom, the Al Rajhis helped them send their earnings home to places like Indonesia and Pakistan.

In 1983, the brothers won permission to open Saudi Arabia's first Islamic bank, one that would observe religious tenets such as a ban on interest.

But relations with the ruling family frayed. The government-controlled press in 1992 publicized Al Rajhi Bank's tangential role in an international scandal of that era, that of the bank called BCCI, U.S. diplomats reported. Then in 1994, an infant relative of the Al Rajhis died in a kidnapping. Official press accounts said the kidnappers slit the child's throat, but Saudi dissidents claimed police shot the child. Mr. Al Rajhi blamed the royal family, the CIA report says.

Although Al Rajhi Bank continued to make a show of support for the Saudis -- annual reports had flowery tributes to the royal family -- the bank began refusing to make loans to the Saudis or to finance their projects, U.S. diplomats said at the time.

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Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 2830877

With its Islamic procedures, the bank was a magnet for the clerical establishment, which grew rich from alms amid the oil boom. As the clerics' charities spread, they became entwined with Al Rajhi Bank and the conservative Al Rajhi family's own extensive financial support for Islamic causes.

There is no reliable estimate of how much the Al Rajhis have given to promote Islam over the years, but an endowment holding much of Saleh Al Rajhi's wealth gives an indication of the scale. Its Web site details nearly \$50 million in direct donations within the kingdom to Islamic causes and at least \$12 million in donations abroad. The overseas money went to aid embattled Muslims in Kosovo, Chechnya and the Palestinian territories and to finance Islamic instruction.

There are indications not all the giving was for such purposes. The Al Rajhi name appeared on a list of regular financial contributors to al Qaeda that was discovered in Sarajevo, Bosnia, in 2002. The list was authenticated for the Federal Bureau of Investigation that year by America's top judicial witness against al Qaeda, a onetime al Qaeda business manager named Jamal Al Fadl, who is in the federal witness-protection program. He called the contributor list the "golden chain."

A 2003 German police report said Sulaiman Al Rajhi and other family members had contributed more than \$200,000 in 1993 to a charity that financed weapons for Islamic militants in Bosnia, in addition to providing humanitarian aid.

The 2003 CIA report tells of efforts by two Al Rajhi brothers to keep some giving secret. It says that Sulaiman and Saleh transferred \$4 million to parties in Germany and Pakistan in December 1998 using "a unique computer code to send funds at regular intervals to unspecified recipients, suggesting they were trying to conceal the transactions and that the money may have been intended for illegitimate ends."

The report says extremists "ordered operatives in Afghanistan, Indonesia, Pakistan, Saudi Arabia, Turkey, and Yemen" to use Al Rajhi Bank. Mamduh Mahmud Salim, convicted mastermind of the 1998 embassy bombings in Kenya and Tanzania, was carrying records of an Al Rajhi account (number 001424/4) when arrested in Germany in 1998, German police found.

In 2000, the CIA report says, Al Rajhi Bank couriers "delivered money to the Indonesian insurgent group Kompak to fund weapons purchases and bomb-making activities."

A U.S. intelligence memo dated Nov. 16, 2001, says a money courier for Osama bin Laden's second-in-command, Ayman al-Zawahiri, traveled on a visa that the bank had obtained for him. The memo adds, however: "Reporting does not indicate whether bank management was witting" of the courier's terrorist connections.

Al Rajhi Bank maintained at least 24 accounts and handled unusual transactions for Al-Haramain foundation -- a charity that Treasury officials say has acted as a front for al Qaeda in 13 countries -- until the Saudi government ordered the charity shut down in late 2004, according to intelligence and

law-enforcement reports. The United Nations has designated top officials of Al-Haramain foundation as terrorists, and most of its offices now are closed. According to a federal indictment in Oregon, a top Al-Haramain official in 2000 carried \$130,000 in \$1,000 traveler's checks from Portland to Riyadh and deposited them with Al Rajhi -- funds the indictment says were for the ultimate benefit of al Qaeda fighters in Chechnya. The indicted official, Soliman Al-Buthe, now works for the city of Riyadh. In an interview, he confirmed carrying the checks and depositing them with Al Rajhi Bank but said that they weren't for al Qaeda and that he did nothing wrong.

A Jidda-based charity called the International Islamic Relief Organization, or IIRO, arranges for donors to send their donations directly to the Al Rajhi Bank. The IIRO's chairman, Adnan Khalil Basha, says the charity is "absolutely apolitical" and has elaborate spending controls to prevent illicit diversions. The charity says it works with Al Rajhi Bank simply because its fees are low and its service is best.

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However, the U.N. has labeled two of the IIRO's branches and some of its officials as al Qaeda supporters. In 2004, the IIRO solicited donations through Al Rajhi Bank for the Iraqi city of Fallujah, then largely under the control of insurgents and the base of the late Abu Musab al Zargawi, who led al Qaeda in Mesopotamia. The IIRO's workers oversaw construction of a trauma clinic in an insurgent-controlled area of Fallujah. The U.S. saw the clinic as a haven for insurgent fighters, and Marines destroyed it in November 2004. That was "a big tragedy for us," says the IIRO's chairman, Mr. Basha.

He denies the charity had any involvement with the Iraqi insurgency. Charity officials complain that the U.S. has produced no evidence of their alleged ties to terrorism.

Two years earlier, federal agents raided the Virginia offices of a network of charities funded by Sulaiman Al Rajhi that worked closely with the IIRO and that -- according to Justice Department court filings -- provided funds to Palestinian terrorists. No charges have been filed.

A year after the 9/11 attacks, U.S. authorities began to lament the lack of Saudi action in taking down terrorists' financial infrastructure. A November 2002 CIA report said the Saudi government "has made little independent effort to uncover terrorist financiers, investigate individual donors, and tighten the regulation of Islamic charities," largely because of "domestic political considerations."

The report advised against a noisy confrontation: "A key factor for continued successful counterterrorism initiatives with the Saudis, whose society is by tradition private, closed, and conservative, will be to ensure that their cooperation with the United States is handled discreetly and kept as much as possible out of the public eye."

The U.S. began to rethink that approach after an al Qaeda attack in Riyadh in May 2003 that killed 26 people, including nine Americans. Deputies from the National Security Council, CIA, Treasury and State departments debated a proposal for legal and political action against Al Rajhi Bank, including the possibility of covert operations such as interfering with the bank's internal operations, according to Bush administration documents and former U.S. officials.

One idea kicked around was "listing or threatening to list" Al Rajhi Bank as a supporter of terrorism. Such a listing can be done if recommended by a committee representing the Treasury, State and Defense departments and the CIA and NSC, and signed by the president. The designation bars U.S. companies from doing business with the named entity. A U.S. designation also normally is forwarded to the U.N., and if that body puts the name on its own terrorist-supporter list, all member states are obliged to freeze the entity's assets.

Other ideas U.S. officials discussed included enlisting friendly countries to step up scrutiny and regulatory action against the Al Rajhis. The CIA report said that "a successful effort against the Al Rajhis would encourage efforts against other donors, or at a minimum, would discourage private funding of Al Qaeda."

Ultimately, the Bush administration again chose merely to continue privately exerting pressure on the Saudis to stiffen their oversight.

\*\*\*\*\*  
This message originated from the Internet. Its originator may or  
may not be who they claim to be and the information contained in  
the message and any attachments may or may not be accurate.  
\*\*\*\*\*

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Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 2830879

From: CHRISTOPHER LOK/HBUS/HSBC  
 Sent: 11/8/2007 9:23:11 AM  
 To: BENJAMIN J SARAM/NBD SIP/HBUS/HSBC@HSBC  
 CC: BENJAMIN J SARAM/NBD SIP/HBUS/HSBC@HSBC; KWOK YING FUNG/NBD  
 SIP/HBUS/HSBC@HSBC; ROGER T K SO/HD NBD RNH/HBUS/HSBC@HSBC;  
 WING KIN - SG CHAN/CEO SIP/HBUS/HSBC@HSBC  
 Subject: Re: ISLAMI BANK BANGLADESH LIMITED

Ben

One, the money is there and we should go for this account.

Two, I will jump in and wear the GRM hat.

Three, I wonder where will can you get that much Saudi. Just relying on what you and HKG can pickup in the region is not enough. Even including London's. So how?

Four, I wouldn't rely on Hersel to help you get the business. And he certainly can't help on clarifying the link to Alrajhi. I would instead suggest we ourselves visit the client and sell our service directly.

I believe we should be able to get the KCY sign off.

Chris

Benjamin J SARAM/NBD SIP/HBUS/HSBC  
 11/08/2007 03:13 AM

To  
 Christopher Lok/HBUS/HSBC@Republic  
 cc  
 Kwok Ying FUNG/NBD SIP/HBUS/HSBC@HSBC, Roger T K SO/HD NBD  
 RNH/HBUS/HSBC@HSBC,  
 Wing Kin - Sg CHAN/CEO SIP/HBUS/HSBC@HSBC, Benjamin J SARAM/NBD  
 SIP/HBUS/HSBC@HSBC  
 Subject  
 Re: ISLAMI BANK BANGLADESH LIMITED

Chris,

Some background on the issue;

According to our colleagues in Dhaka, approximately 60,000 Bangladeshis make their way to Saudi Arabia annually to perform the Haj. It is estimated that each pilgrim will require approximately USD1,000-3,000 in currency for expenses. On the low side, we're therefore looking at about USD 60 mio of currency needs on an annual basis.

Permanent Subcommittee on Investigations

EXHIBIT #82

Confidential - FOIA Treatment Req  
 Confidential - FOIA Treatment Req

ngs, Inc. HSB01123155  
 HSBC OCC 0739987

There is a shortage of SAR in the market. Most of it is now supplied by money changers and banks who recycle SAR notes that come in from the transient worker population working in the Middle East. Pilgrims who can't secure enough SAR will carry USD notes with them to Saudi Arabia, where they will change them into riyals.

There is therefore an underserved demand here, one that Islami Bank is looking to capitalize on. Assuming that about half of all pilgrims would prefer to change SAR in Bangladesh instead of in Saudi Arabia, that's an annual requirement of about SAR112 mio. Assuming again that we take a conservative margin of 2.5 per mille, our estimated net profit would be approximately USD 75,000/ year.

Bangladesh is a relatively small market, but there is potential. Our total volume in '06 was USD37.1 mio, garnering us NTI of approximately USD47,000. Comparatively, our volume YTD Oct '07 is USD 46 mio, garnering us NTI of approximately USD72,000. We expect the full year's NTI to be around 75,000, representing growth of about 53% year-on-year. We are a monopoly here, and margins are decent.

I understand that Hersel Mehani is quite close to Islami, and PCM already has dealings with the prospect. Would this help in supporting our bid to open the account, should we decide to proceed?

Regards,  
Ben

Christopher Lok/HBUS/HSBC  
08 Nov 2007 01:29 Mail Size: 8086

To  
Kwok Ying FUNG/NBD SIP/HBUS/HSBC@HSBC  
cc  
Benjamin J SARAM/NBD SIP/HBUS/HSBC@HSBC, Wing Kin - Sg CHAN/CEO  
SIP/HBUS/HSBC@HSBC, Roger T K SO/HD NBD RNH/HBUS/HSBC@HSBC  
Subject  
Re: ISLAMI BANK BANGLADESH LIMITED

Our Ref

Your Ref

Mr Fung

First, I'm happy to be the RM if this is an account worth chasing. How much money you can expect to make from this name? If this can be answered positively then I will ask PCM to check out the connection between the alrajhi

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connection. I've looked at the Alrajhi Bank profile and found out an identical Abdul Aziz Alrajhi (chairman of the papermill co. in the Islamic profile) also appearing in the Alrajhi profile. If this is the same person then we have to assume there's cross-connection between the Alrajhi Bank and Islamic Bank. We need clarification.

The name Alrajhi has been a name heatedly debated for many years. We terminated our trading relationship following 911 and only a year ago after London Compliance came back telling NYK the group is happy to let us resurrect the relationship that we went back. You should check out the Alrajhi Bank profile - done by Gordon Brown and comprehensive.

Not saying just because of this connection we won't do business. Its just that if the revenue is there then we're prepared for a good fight. But before that lets get the facts straightened out.

So come back to me with the expected NTI. Also tell me the entire Bangladesh market's worth please.  
Chris

Kwok Ying FUNG/NBD SIP/HBUS/HSBC wrote on 11/06/2007 11:12:44 PM:

> Chris  
>  
> The following mails are self-explanatory. Would you consider to be  
> the RM approver of subject PCM-SN shared client?  
>  
> Regards.  
>  
> KY  
> — Forwarded by Kwok Ying FUNG/NBD SIP/HBUS/HSBC on 11/07/2007  
> 12:00 PM —  
>  
> Beth Fisher/HBUS/HSBC  
> 07 Nov 2007 03:07 Mail Size: 15898  
>  
> To  
>  
> Angela Cassell-Bush/HBUS/HSBC@HSBC  
>  
> cc  
>  
> Benjamin J SARAM/NBD SIP/HBUS/HSBC@HSBC, Gillian E  
> Bachstein/HBUS/HSBC@HSBC02, Kwok Ying FUNG/NBD SIP/HBUS/HSBC@HSBC  
>  
> Subject  
>  
> Re: Fw: KYC BankNotes Profile is IB Denied for: ISLAMIC BANK BANGLADESH LIMITED  
>  
> Our Ref  
>  
> Your Ref  
>  
> Additionally, I had mentioned to Gillian the past relationships with  
> Al Rajhi. In particular, a couple/few years ago, HBUS exited the  
> relationship with Al Rajhi Banking & Investment due to Compliance  
> concerns. (I do not recall all the details). I do see that the  
> relationship was re-activated. Gillian was going to cross-check the  
> Al Rajhi ownership of Islamic Bank with our old KYCs for Al Rajhi

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> Banking & Investment and Al Rajhi Trading Establishment.  
 >  
 > This is not just an RM issue. This is a KYC due diligence issue.  
 >  
 > Beth  
 >  
 >  
 >  
 >  
 > Angela Cassell-Bush/HBUS/HSBC  
 > 11/06/2007 01:41 PM  
 >  
 > To  
 >  
 > Kwok Ying FUNG/NBD SIP/HBUS/HSBC@HSBC  
 >  
 > cc  
 >  
 > Gillian E Bachstein/HBUS/HSBC@HSBC02, Benjamin J SARAM/NBD  
 > SIP/HBUS/HSBC@HSBC, Beth Fisher/HBUS/HSBC@HSBC  
 >  
 > Subject  
 >  
 > Re: Fw: KYC BankNotes Profile is IB Denied for: ISLAMI BANK BANGLADESH LIMITED  
 >  
 > Kwok:  
 >  
 > Unfortunately, the KYC profile for ISLAMI BANK BANGLADESH LIMITED  
 > has been IB denied by Beth Fisher because the client is not known to  
 > CIB. As it stands, we have not been able to identify the RM  
 > Approving person for this relationship. I would suggest that you  
 > reach out to Chris Lok to see if he is willing to be the RM  
 > Approver. Once this is confirmed, let me know and I will resubmit  
 > this through the approval chain.  
 >  
 > Regards,  
 >  
 > Angela Cassell-Bush  
 > Compliance Officer | HSBC Bank USA  
 > 90 Christiana Road New Castle, DE 19720  
 >  
 >  
 >  
 > Phone. 302-327-2017  
 > Fax. 302-327-2128  
 > Email. angela.cassell-bush@us.hsbc.com  
 >  
 >  
 >  
 > Kwok Ying FUNG/NBD SIP/HBUS/HSBC  
 > 10/24/2007 10:41 PM  
 >  
 > To  
 >  
 > Jarrett L Payne/HBUS/HSBC@HSBC, Angela Cassell-Bush/HBUS/HSBC@HSBC  
 >  
 > cc

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 Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 0739990



>  
 > Benjamin J SARAM/NBD SIP/HBUS/HSBC@HSBC  
 >  
 > Subject  
 > Fw: KYC BankNotes Profile is IB Denied for: ISLAMI BANK BANGLADESH LIMITED  
 >  
 > Dear Jarrett / Angela  
 >  
 > Our banknote profile was "IB Denied" by Beth as she is not the RM.  
 > Could you please update the client profile with the correct RM? I  
 > understand the client profile right now is also "IB Denied", kindly  
 > advise us once you put the profile back to approval process. Thank you.  
 >  
 > Best regards,  
 >  
 > KY  
 >  
 > ----- Forwarded by Kwok Ying FUNG/NBD SIP/HBUS/HSBC on 10/25/2007  
 > 10:14 AM -----  
 >  
 > Beth Fisher/HBUS/HSBC  
 > 24 Oct 2007 22:29 Mail Size: 1908  
 >  
 > To  
 > Kwok Ying FUNG/NBD SIP/HBUS/HSBC@HSBC  
 >  
 > cc  
 >  
 > Subject  
 >  
 > KYC BankNotes Profile is IB Denied for: ISLAMI BANK BANGLADESH LIMITED  
 >  
 > Our Ref  
 >  
 > Your Ref  
 >  
 > A BankNote Profile in BANGLADESH for HSBC Office Singapore, has been  
 > IB Denied (Reference #20501761).  
 >  
 > Click on the attachment to link to the BankNote Profile.

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 Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 0739991

Occ-Psi-00154139  
 From: ANGELA CASSELL-BUSH/HBUS/HSBC  
 Sent: 11/9/2007 10:57:40 AM  
 To: CHRISTOPHER LOK/HBUS/HSBC@HSBC  
 CC: BENJAMIN J SARAM/NBD SIP/HBUS/HSBC@HSBC; WING KIN - SG CHAN/CEO  
 SIP/HBUS/HSBC@HSBC;  
 GILLIAN E BACHSTEIN/HBUS/HSBC@HSBC02; PSRR@HSBC  
 Subject: Re: ISLAMI BANK BANGLADESH LIMITED-Bangladesh

Chris,

In response to your inquiry, please note that there is a connection between ISLAMI BANK BANGLADESH LIMITED-Bangladesh and Al-Rajhi Bank (aka: Al Rajhi Banking and Investment Corporation).

Based on the information that we have on file, the Al- Rajhi family has been associated with Islami Bank Bangladesh Limited, since its inception. They have at least 37% direct ownership within ISLAMI BANK BANGLADESH LIMITED through their ownership within the following companies; Arabsas Travel & Tourist Agency, 9.999%, Janab Yousif Abdullah Abdul Aziz Al-Rajhi, 9.936%; Al-Rajhi Company for Industry & Trade, 9.94%; Abdullah Abdul Aziz Al-Rajhi, 7.58%

This same family has major controlling interest within Al-Rajhi bank (aka Al Rajhi Banking and Investment Corporation).

Hope this helps. Please let me know if this information is satisfactory.

Regards,

Angela Cassell-Bush  
 Compliance Officer | HSBC Bank USA  
 90 Christiana Road New Castle, DE 19720

Phone. 302-327-2017  
 Fax. 302-327-2128  
 Email. angela.cassell-bush@us.hsbc.com

Christopher Lok/HBUS/HSBC  
 11/08/2007 10:17 AM

To  
 Kwok Ying FUNG/NBD SIP/HBUS/HSBC@HSBC  
 CC  
 Benjamin J SARAM/NBD SIP/HBUS/HSBC@HSBC, Wing Kin - Sg CHAN/CEO  
 SIP/HBUS/HSBC@HSBC, Angela Cassell-Bush/HBUS/HSBC@HSBC, Gillian E  
 Bachstein/HBUS/HSBC@HSBC02  
 Subject  
 ISLAMI BANK BANGLADESH LIMITED

KY

Further to my email exchange with Ben, I like to confirm that I'll be happy to be the GRM of this banknotes prospect/PCM client. However I would like to ask  
 Page 1

Permanent Subcommittee on Investigations  
**EXHIBIT #83**

955

Occ-Psi-00154139  
Gillian and company to find out the possible link between this name and the Alrajhi Bank (an approved name for Banknotes business).  
Beth's statement about Alrajhi Trading Est is irrelevant as that's name we long ago taken out of our profile. That name is not related to the Alrajhi Bank.  
I've looked at the Alrajhi Bank profile and noted a chap by the same name who owns the papermill (Islamic).  
Chris

Kwok Ying FUNG/NBD SIP/HBUS/HSBC  
11/06/2007 11:12 PM

To  
Christopher Lok/HBUS/HSBC@HSBC  
Cc  
Wing Kin - Sg CHAN/CEO SIP/HBUS/HSBC@HSBC, Benjamin J SARAM/NBD  
SIP/HBUS/HSBC@HSBC  
Subject  
ISLAMI BANK BANGLADESH LIMITED

Chris

The following mails are self-explanatory. Would you consider to be the RM approver of subject PCM-BN shared client?

Regards.

KY

----- Forwarded by Kwok Ying FUNG/NBD SIP/HBUS/HSBC on 11/07/2007 12:00 PM -----

Beth Fisher/HBUS/HSBC  
07 Nov 2007 03:07 Mail Size: 15898

To  
Angela Cassell-Bush/HBUS/HSBC@HSBC  
Cc  
Benjamin J SARAM/NBD SIP/HBUS/HSBC@HSBC, Gillian E  
Bachstein/HBUS/HSBC@HSBC02,  
Kwok Ying FUNG/NBD SIP/HBUS/HSBC@HSBC  
Subject  
Re: Fw: KYC BankNotes Profile is IB Denied for: ISLAMI BANK BANGLADESH  
LIMITED

Our Ref

Your Ref

Page 2

Occ-Psi-00154139

Additionally, I had mentioned to Gillian the past relationships with Al Rajhi. In particular, a couple/few years ago, HBUS exited the relationship with Al Rajhi Banking & Investment due to Compliance concerns. (I do not recall all the details). I do see that the relationship was re-activated. Gillian was going to cross-check the Al Rajhi ownership of Islami Bank with our old KYCs for Al Rajhi Banking & Investment and Al Rajhi Trading Establishment.

This is not just an RM issue. This is a KYC due diligence issue.

Beth

Angela Cassell-Bush/HBUS/HSBC  
11/06/2007 01:41 PM

To  
Kwok Ying FUNG/NBD SIP/HBUS/HSBC@HSBC  
CC  
Gillian E Bachstein/HBUS/HSBC@HSBC02, Benjamin J SARAM/NBD  
SIP/HBUS/HSBC@HSBC,  
Beth Fisher/HBUS/HSBC@HSBC  
Subject  
Re: Fw: KYC BankNotes Profile is IB Denied for: ISLAMI BANK BANGLADESH  
LIMITED

Kwok:

Unfortunately, the KYC profile for ISLAMI BANK BANGLADESH LIMITED has been IB denied by Beth Fisher because the client is not known to CIB. As it stands, we have not been able to identify the RM Approving person for this relationship. I would suggest that you reach out to Chris Lok to see if he is willing to be the RM Approver. Once this is confirmed, let me know and I will resubmit this through the approval chain.

Regards,

Angela Cassell-Bush  
Compliance Officer | HSBC Bank USA  
90 Christiana Road New Castle, DE 19720

Phone. 302-327-2017  
Fax. 302-327-2128  
Email. angela.cassell-bush@us.hsbc.com

Kwok Ying FUNG/NBD SIP/HBUS/HSBC  
10/24/2007 10:41 PM

957

Occ-Psi-00154139

To  
Jarrett L Payne/HBUS/HSBC@HSBC, Angela Cassell-Bush/HBUS/HSBC@HSBC  
cc  
Benjamin J SARAM/NBD SIP/HBUS/HSBC@HSBC  
Subject  
Fw: KYC BankNotes Profile is IB Denied for: ISLAMI BANK BANGLADESH LIMITED

Dear Jarrett / Angela

Our banknote profile was "IB Denied" by Beth as she is not the RM. Could you please update the client profile with the correct RM? I understand the client profile right now is also "IB Denied", kindly advise us once you put the profile back to approval process. Thank you.

Best regards.

KY

----- Forwarded by Kwok Ying FUNG/NBD SIP/HBUS/HSBC on 10/25/2007 10:14 AM -----

Beth Fisher/HBUS/HSBC  
24 Oct 2007 22:29 Mail Size: 1908

To  
Kwok Ying FUNG/NBD SIP/HBUS/HSBC@HSBC  
cc  
Subject  
KYC BankNotes Profile is IB Denied for: ISLAMI BANK BANGLADESH LIMITED

Our Ref

Your Ref

A BankNote Profile in BANGLADESH for HSBC Office Singapore, has been IB Denied (Reference #20501761).

Click on the attachment to link to the BankNote Profile.

Page 4

HSBC-BNL\_E 0050761.txt

From: DANIEL JACK/HBUS/HSBC  
 Sent: 8/18/2009 12:44:40 PM  
 To: CHRISTOPHER LOK/HBUS/HSBC@HSBC02@HSBC; HOW WEI ONG/LGA SGH/HBAP/HSBC@HSBC03  
 CC: DENIS E O'BRIEN/HBUS/HSBC@HSBC02; GEORGE JAMES/NBD SIP/HBUS/HSBC@HSBC03; GILLIAN E  
 BACHSTEIN/HBUS/HSBC@HSBC02;  
 VALERIE E COLE-HUDSON/HBUS/HSBC@HSBC02  
 Subject: EDD Report of Findings: [REDACTED] Bank Ltd in Bangladesh (BN-SP & PCM)

Chris,

I agree that we expect breaches in a large bank. But this is government-owned in a high risk country with a PEP and reputational risk due to corruption, etc. Their KYC profile documents various allegations of fraud, internal control weaknesses, and the FBI investigation into terrorist financing (Section I - General Comments) and the EDD ROF has more recent negative information. Also, as noted below, the Chairman of [REDACTED] Bank Ltd, [REDACTED] is a PEP because he was Deputy Secretary in the Ministry of [REDACTED]

PSRR is reviewing this client and should reply soon with their analysis & recommendation from PCM.

How Wei - As LCO in Singapore, please review the KYC profile, EDD report, and e-mails below. Then let us know if you recommend SCC classification (for PEP and/or reputational risk) for this PCM and Banknote-Singapore client.

[REDACTED] Bank Limited - in BANGLADESH

KYC Profile -->

EDD ROF:

Thanks and regards,

Daniel Jack  
 Vice President - Compliance Officer, GRB  
 HSBC Bank USA, NA  
 452 Fifth Avenue, 7th floor, New York, NY 10018

Phone. 212-525-8686  
 Email. daniel.jack@us.hsbc.com

Christopher Lok/HBUS/HSBC@HSBC02  
 08/18/2009 01:08 PM

To  
 Daniel Jack/HBUS/HSBC@HSBCAMERICAS  
 CC  
 Denis E O'Brien/HBUS/HSBC@HSBC02, George JAMES/NBD SIP/HBUS/HSBC@HSBC03,  
 Gillian E Bachstein/HBUS/HSBC@HSBC02, Valerie E Cole-Hudson/HBUS/HSBC@HSBC02  
 Subject  
 Re: EDD Report of Findings: [REDACTED] Bank Ltd in Bangladesh (BN-SP & PCM)

Page 1

[REDACTED] = Redacted by the Permanent Subcommittee on Investigations

Permanent Subcommittee on Investigations

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 Confidential - FOIA Treatment Re

EXHIBIT #84a

Jings, Inc. HSB08071921  
 HSBC OCC 7688017

HSBC-BNI\_E 0050761.txt

Dan

I support Hersel's stance that this is such a large bank hence malfeasance is expected. However I do not agree that just on these numerous breaches the bank should be classified.

Bank has a recent case of a bank officer in the private banking business admitted to having stolen HKD100 million from the bank. Should we then classify Bank, a 62% sub of HSBC, an SCC?

Chris

Daniel Jack/HBUS/HSBC  
08/18/2009 11:45 AM

To  
Gillian E Bachstein/HBUS/HSBC@HSBC02, Christopher Lok/HBUS/HSBC@HSBC02  
Cc  
Valerie E Cole-Hudson/HBUS/HSBC@HSBC02, George JAMES/NBD  
SIP/HBUS/HSBC@HSBC03  
Denis E O'Brien/HBUS/HSBC@HSBC02  
Subject  
EDD Report of Findings: Bank Ltd in Bangladesh (BN-SP & PCM)

Gillian / Chris,

Do you agree with SCC classification for this BN &amp; PCM shared client?

Thanks and regards,

Daniel Jack  
Vice President - Compliance Officer, GTB  
HSBC Bank USA, NA  
452 Fifth Avenue, 7th Floor, New York, NY 10018

Phone. 212-525-8686  
Email. daniel.jack@us.hsbc.com

----- Forwarded by Daniel Jack/HBUS/HSBC on 08/18/2009 11:41 AM -----

Hersel Mehani/HBUS/HSBC  
08/17/2009 11:50 AM

To  
Daniel Jack/HBUS/HSBC@HSBC02  
Cc  
Anthony Julian/HBUS/HSBC@HSBC02, Christopher Lok/HBUS/HSBC@HSBC02, Denis E O'Brien/HBUS/HSBC@HSBC02, George JAMES/NBD SIP/HBUS/HSBC@HSBC03, Gillian E  
Page 2

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HSBC-BN1\_E 0050761.txt  
 Bachstein/HBUS/HSBC@HSBC02, Jacob X Houseknecht/HBUS/HSBC@HSBC02, Roger T K  
 SO/HD NBD RNH/HBUS/HSBC@HSBC03, Valerie E Cole-Hudson/HBUS/HSBC@HSBC02, Wing  
 Kin - Sg CHAN/CEO SIP/HBUS/HSBC@HSBC03  
 Subject  
 Re: EDO Report of Findings: [REDACTED] Bank Ltd in Bangladesh (BN-SP & PCM)

Daniel  
 Many thanks for your updated information,  
 I will support SCC classification for 6 month to allow the local GRM and RM  
 to do a full review of subject bank Sr. mgts and secure that internal controls  
 are in place.  
 As you know the bank being the [REDACTED] Govt Owned will always faces such  
 issues at a lower level of bank management's.  
 I am aware that the Sr Management and Senior officer are screened and  
 officially chosen by the board of the central bank and from past experience  
 they have chosen honest and professional Bankers. However they will always  
 have exposure to some officers who will abuse their power and take advantage  
 of the bureaucratic system of the bank.

Overall I am comfortable with the relationship we presently have on the PCM and  
 will support retaining this account

Thanks and regards,

Hersef Mehani  
 Senior Vice President | HSBC Bank USA N.A.  
 Global Payments and Cash Management  
 432 Fifth Avenue, Floor 21, New York NY 10018, USA

Phone. +1-212-525-6239  
 Fax. +1-212-525-5699  
 Mobile. [REDACTED]  
 Email. hersef.mehani@us.hsbc.com  
 Internet. HSBC Global Payments and Cash Management  
 HSBC Global Site

Daniel Jack/HBUS/HSBC  
 17/08/2009 11:29 AM

To  
 Valerie E Cole-Hudson/HBUS/HSBC@HSBC02, Wing Kin - Sg CHAN/CEO  
 SIP/HBUS/HSBC@HSBC03  
 CC  
 Gillian E Bachstein/HBUS/HSBC@HSBC02, Roger T K SO/HD NBD  
 RNH/HBUS/HSBC@HSBC03,  
 Christopher Lok/HBUS/HSBC@HSBC02, Anthony Julian/HBUS/HSBC@HSBC02, Hersef  
 Mehani/HBUS/HSBC@HSBC02, Denis E O'Brien/HBUS/HSBC@HSBC02, Jacob X  
 Houseknecht/HBUS/HSBC@HSBC02, George JAMES/NBD SIP/HBUS/HSBC@HSBC03  
 Subject  
 EDO Report of Findings: [REDACTED] Bank Ltd in Bangladesh (BN-SP & PCM)

Page 3

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HSBC-BNI\_E 0050761.txt

Valerie / WK,

We will need a response from the client in Bangladesh and the business (BN/PCM, RM, etc.) regarding the negative information identified in this EDO ROF. This is a PCM and Banknote-Singapore shared client, so you may want to collaborate with each other and the RM & Sales Manager on this - and determine/confirm whether you want to maintain them as a client in each of your respective businesses. Resolution of the issues and risk mitigants would need to be well-documented.

And we need to consider SCC classification due to reputational risk.

██████████ Bank Limited KYC ---->

Thanks and regards,

Daniel Jack  
Vice President - Compliance Officer, GTB  
HSBC Bank USA, NA  
452 Fifth Avenue, 7th floor, New York, NY 10018

Phone. 212-525-8686  
Email. daniel.jack@us.hsbc.com

----- Forwarded by Daniel Jack/HBUS/HSBC on 08/17/2009 11:15 AM -----

FIG HBUS@HSBC03  
Sent by: Padma M Meesala@HSBC03  
08/17/2009 05:56 AM

To  
Daniel Jack/HBUS/HSBC@HSBC02  
cc  
Jacob X Houseknecht/HBUS/HSBC@HSBC02, Jackie S K QUAH/NBD  
SIP/HBUS/HSBC@HSBC03,  
FIG HBUS@HSBC02  
Subject  
Report of Findings: ██████████ Bank Ltd in Bangladesh; FIU

Please find attached Report of Findings on ██████████ Bank Limited.

\* Please note that for your convenience, space for Compliance Officer and/or Business Unit comments has been reserved at the bottom of this report.

[attachment ██████████ Bank- Final-doc.zip" deleted by Hersel Mehani/HBUS/HSBC]

Please feel free to contact Jessica Dubensky (212-5255746) if you have any queries.

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HSBC-BNI\_E 0050761.txt

Daniel Jack  
13 Mar 2009 22:09

To: FIG HBUS@HSBC02

cc: Jacob X Houseknecht/HBUS/HSBC@HSBC02  
Jackie S K QUAH/NBD SIP/HBUS/HSBC@HSBC03  
Subject: EDD for [REDACTED] Bank [REDACTED] in Bangladesh [REDACTED]

FIG,

Please provide us with an updated EDD ROF for this PCM and Banknote [REDACTED] client in Bangladesh. The prior ROF is dated 19-Jun-06.

I have risk scored this request to be 31 now, due to the recent corruption conviction [REDACTED] in May 2008 of [REDACTED], the bank's [REDACTED] [REDACTED] [REDACTED] along with embezzlement by 3 bank officials in 2006].

Refer to attached form and ALE below.

[attachment "EDD ROF for [REDACTED] Bank [REDACTED] Bangladesh (13-Mar-09).xls.zip" deleted by Hersel Mehani/HBUS/HSBC]

Thanks and regards,

Daniel Jack  
Vice President - Compliance Officer, GTB  
HSBC Bank USA, NA  
452 Fifth Avenue, 7th floor, New York, NY 10018

Phone. 212-525-8686  
Email. daniel.jack@us.hsbc.com

----- Forwarded by Daniel Jack/HBUS/HSBC on 03/13/2009 12:25 PM -----

Jacob X Houseknecht/HBUS/HSBC  
03/13/2009 11:26 AM

To  
Daniel Jack/HBUS/HSBC@HSBC02  
Cc

Subject  
Fw: [REDACTED] (Bangladesh) - [REDACTED]

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Daniel,

Good morning. We are in the process of the annual review for [REDACTED] located in Bangladesh. I have attached the ROF request form (score 25) for your review.  
[attachment "[REDACTED] Bank Limited.xls" deleted by Hersel Mehani/HBUS/HSBC]

I have also included the results from an RAU search conducted on 3/12/2009.  
Page 5

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Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSB0CC 7688021

HSBC-BNL\_E 0050761.txt

The bank is listed as a PEP because it is owned by the government. There was information found on our internal database that seems to have already been addressed previously in the KYC (In General Comments). The last listing is for the chairman, [REDACTED] who is listed as a PEP, however he no longer holds any of the positions listed. It seems to me that no further action needs to be taken on these items, however I wanted to get your opinion on the matter.

Lastly, a media search of [REDACTED] Bank and corruption returned a story about a [REDACTED]

Since this information is not directly related to AML, is it something I should still pursue from the GRM to get a response for? If so, what types of questions would be relevant to this situation. Your help and guidance is much appreciated.

Thank you,

Jake Houseknecht  
PSRR

HSBC Bank USA, N.A.  
90 Christiana Road  
New Castle, DE 19720  
(302) 327-2520

Jacob X Houseknecht/HBUS/HSBC

----- Forwarded by Jacob X Houseknecht/HBUS/HSBC on 03/13/2009 11:04 AM -----

RAU HBUS

Sent by: Benjamin X Ciurdar  
03/12/2009 04:54 PM

To: Jacob X Houseknecht/HBUS/HSBC@HSBC02  
Cc: RAU HBUS@HSBC02, ICRO ALE@HSBC02  
Subject: [REDACTED]  
Re: [REDACTED] (Bangladesh) [REDACTED]

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Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSB08071927

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Permanent Subcommittee on Investigations

HSB08071928  
HSBC OCC 7688024

HSB08071927  
HSBC OCC 7688023

HSBC-BNI\_E 0006344.txt  
 From: CHRISTOPHER LOK/HBUS/HSBC  
 Sent: 9/2/2005 10:28:47 AM  
 To: SHARYN MALONE/HBUS/HSBC@HSBCAMERICAS  
 CC:  
 Subject: Fw: Report of Findings - [REDACTED] FIG

Sharyn

I'm very fed up with these people.

----- Forwarded by Christopher Lok/HBUS/HSBC on 09/02/2005 11:31 AM -----

Christopher Lok/HBUS/HSBC  
 09/02/2005 11:20 AM

To  
 Wing Kin - HK CHAN/NBD RNH/HBUS/HSBC, Daniel Jack/HBUS/HSBC  
 CC  
 Betty F S NG/NBD RNH/HBUS/HSBC@HSBC, Bruce LI/RNH/HBUS/HSBC@HSBC, Gary C H  
 YEUNG/SVP NBD RNH/HBUS/HSBC@HSBC, Roger T K SO/HD NBD RNH/HBUS/HSBC@HSBC, Tom K  
 LAU/VP NBD RNH/HBUS/HSBC@HSBC, John S GUBERT/HGHQ/HSBC@HSBC, Lynda J  
 Cassell/HBUS/HSBC@HSBC  
 Subject  
 Re: Fw: Report of Findings - [REDACTED] Bank - FIG

I disagree wholeheartedly with FIG's recommendation. FIG displays ignorance to the banking hierarchy of the [REDACTED] banks. As said many times, all state owned banks in [REDACTED] are appointed by the Govt and this is not the ground to think that the person is a PEP.

Yes, corruption can be rampant in this bank, but it is not unique to [REDACTED] Bank. Without exception all [REDACTED] State owned banks have been and will continue to be plagued by misuse of state's money, corruption and delinquent loans. That's why alone this year the State has injected over [REDACTED] billion into the [REDACTED] banks. This is all public knowledge.

Bank [REDACTED] in which HSBC has a 19% stake is the [REDACTED] State Owned Bank and I'm sure HSBC must have found impropriety. Shall we then classify this name as an SCC?

My point is HBUS being a US entity cannot simply use the excuse that because of US regulators' attention and then say that 'I want to classify this name as an SCC because of the adverse reputation this institution has'.

If somebody in HSBC wants to take that view it will be at the group level. Proper consultation must be held at the Group Compliance Level with the senior executives of the Bank to examine this question: Are the State owned Banks in [REDACTED] or not.

John: Could you please discuss this with Iain and get his opinion. I want to elevate this to a much higher level now as I want a quick resolution rather than continue engaging myself in these unnecessary discussions.

Chris

Page 1

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Permanent Subcommittee on Investigations  
 EXHIBIT #84b

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ldings, Inc. HSB00161691  
 A. HSB00161691

HSBC-BNL\_E 0006344.txt

Wing Kin - HK CHAN/NBD RNH/HBUS/HSBC  
09/01/2005 09:21 PM

To  
Christopher Lok/HBUS/HSBC@HSBC, Roger T K SO/HD NBD RNH/HBUS/HSBC@HSBC, Gary  
C  
H YEUNG/SVP NBD RNH/HBUS/HSBC@HSBC, Tom K LAU/VP NBD RNH/HBUS/HSBC@HSBC, Bruce  
LI/RNH/HBUS/HSBC@HSBC  
CC  
Betty F S NG/NBD RNH/HBUS/HSBC@HSBC  
Subject  
FW: Report of Findings - [REDACTED] Bank - FIG

For your information.

Best regards  
WK

----- Forwarded by Wing Kin - HK CHAN/NBD RNH/HBUS/HSBC on 09/02/2005 09:15 AM

Daniel Jack/HBUS/HSBC  
HBUS  
09/02/2005 05:02 AM  
Mail Size: 37403

To  
Wing Kin - HK CHAN/NBD RNH/HBUS/HSBC@HSBC  
CC  
Subject  
FW: Report of Findings - [REDACTED] Bank - FIG  
Our Ref  
Your Ref

FYI - FIG recommends this BN-HK client be an SCC, so PCM will follow-up...

----- Forwarded by Daniel Jack/HBUS/HSBC on 09/01/2005 05:02

PM  
FIG HBUS on 01 Sep 2005 16:30  
Note  
01 Sep 2005 16:30

From: FIG HBUS Tel:  
Title: Location:  
Workgroup: Mail Size: 28892  
Sent by: Michael Ellis

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To: Shannon M Jones/HBUS/HSBC@HSBC HSBC-BNZ\_E 0006344.txt

cc: Ginny Tsuei/HBUS/HSBC@HSBC  
Rhonda Lee-Thomas/HBUS/HSBC@HSBC  
Andree Gailindo/HBUS/HSBC@HSBC  
Paul DiBenedetto/HBUS/HSBC@HSBC  
Nanayo Ryan/HBUS/HSBC@HSBC  
Pierre Nasser/HBUS/HSBC@HSBC  
George Tsugranes/HBUS/HSBC@HSBC  
Alan T Ketley/HBUS/HSBC@HSBC  
Daniel Jack/HBUS/HSBC@HSBC  
FIG HBUS@HSBC  
Kristen O'Connell/HBUS/HSBC@HSBC  
Subject: Report of Findings - [REDACTED] Bank - FIG

#### REMARKS/RECOMMENDATIONS

Shannon,

As you will read in the below Report of Findings for [REDACTED] Bank, the bank's senior management and employees have been involved in numerous significant instances of corruption, fraud, and embezzlement over the past few years. Highlights of such instances (detailed in the reports below) involving [REDACTED] Bank's management include the following:

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Also, [REDACTED] Bank should be considered for Special Category of Client (SCC) status due to its current President being categorized as a Politically Exposed Person (PEP) on World-check (details below).

For the above reasons, and the additional instances of financial crime involving the Bank's employees, as detailed below, we recommend that [REDACTED] Bank's account relationships with HSBC be closely monitored. The number of instances of corruption, fraud and embezzlement at this institution appears high when compared to other institutions that we have reviewed, and may be indicative of lax controls at the Bank. This is especially of concern given the fact that many of these cases have involved [REDACTED] Bank's management and top executives.

Much of the information pertaining to the instances of corruption, fraud and embezzlement at [REDACTED] Bank was obtained subsequent to our previous Report of Findings in October 2003. Therefore, we recommend that you consider these findings and discuss them with your Local Compliance Officer (LCO).

Sincerely,

Page 3

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HSBC OCC 7690027-032  
Redacted by the Permanent Subcommittee on Investigations

HSB00161693  
HSBC OCC 7690026

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## Know Your Customer Profile

HSBC Bank USA, N.A.

Version 7.0

Reference: [REDACTED] Client Profile Approval Status: CO Denied

Country Risk Status: High Risk  
High Risk Client Type: Special Category of Client

Needs Re-Approval

Client Name: AL RAJHI BANKING & INVESTMENT CORP  
Country: SAUDI ARABIA

\* Changes to these fields on "Approved" Profiles require Re-approval.

### I. General Information

Client Name: AL RAJHI BANKING & INVESTMENT CORP	
Is this a Client of Global Payments and Cash Management (PCM in Delaware)?	<input type="radio"/> Yes <input checked="" type="radio"/> No
Is this a Client of Corporate and Institutional Banking (CIB)?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, CIB Industry:	Banking
* Client Activity Status:	Deactivated
Deactivation Date:	10/14/2010
Deactivation Reason:	<input type="radio"/> KYC/ Compliance Reason <input checked="" type="radio"/> Business Reason <input type="radio"/> Other
Comments:	Due to imminent closure of Banknote business and lack of recent dealings.
* Client Category:	<input type="radio"/> Domestic Financial Institution <input checked="" type="radio"/> Foreign Financial Institution <input type="radio"/> Investment Advisor or Fund <input type="radio"/> Corporate Client <input type="radio"/> Sole Proprietor or Partnership
Type of Client:	<input checked="" type="radio"/> Bank <input type="radio"/> Non-Bank
Legal entity:	<input checked="" type="radio"/> Parent <input type="radio"/> Branch <input type="radio"/> Subsidiary
Is the Client a Central Bank?	<input type="radio"/> Yes <input checked="" type="radio"/> No
* Is Client a Special Category of Client? (Refer to Group Policy GCL 000074 on SCCs)	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, SCC Type:	1 - PEP owned or managed (Politically Exposed Person has "direct" influence)
What information source was used to categorize this Client as an SCC (e.g., Compliance)?	AML Compliance New York recommendation based on ICRO reports
To whom is this Client connected and how (relationship)? (Indicate name of Politically Exposed Person ("PEP") or other SCC ownership or management role with Client, and outside interest/position/title)	Director, Abdullah Abdul Al Rajhi, is a member in the Northern Borders Provincial Council in Saudi Arabia.
Has the Client's name and location been checked against:	

Permanent Subcommittee on Investigations  
**EXHIBIT #85**

Confidential Treatment Requested

HSBC-PSI-PROD-0102310

Government lists of known or suspected terrorists or criminals (e.g., OFAC and World-Check)?		<input type="radio"/> Yes <input type="radio"/> No	
[This is to be completed for prospects only - existing clients are examined monthly, and when the OFAC list changes.]			
Address (Business / Permanent) (A PO Box alone is not sufficient for address.)		P.O. Box 28, Al Akasiya Building, Olaya Street, 11411	
City:		Riyadh	
* Country:		SAUDI ARABIA	
Telephone:		+966 1 4601000 +966 1 2116000	
Email address of Client contact:		docrat@alrajhibank.com.sa (Cassim Docrat, AGM, Head of Financial Institutions)	
Client's URL (Web Site):		www.alrajhibank.com.sa	
Fax:		+966 1 4600922 +966 1 4601518	
Swift Code:		RJHI SA RI	
Taxpayer ID (EIN or SSN):		0	
New Client or Existing Client:		<input type="radio"/> New (prospect) <input checked="" type="radio"/> Existing (active) <input type="radio"/> Agency Arrangements only	
Account Number:		[REDACTED]	
Date Account Activated:		08/10/2007	
* Purpose of Account:		Banknotes trading	
Is the Client or its Parent traded on an Exchange?			
<input checked="" type="radio"/> Yes <input type="radio"/> No			
If yes, Name of Exchange:			
Saudi Arabian Stock Exch (Tadawul)			

[illegible]

<p><b>General comments:</b></p>	<p>All-Rajhi Banking and Investment Corp. is one of the largest banking companies in Saudi Arabia. Banknotes delivery address: 161 King Abdul Aziz St. Jeddah, Saudi Arabia. They are not an agent for Money Transfer Service as at 14th January 2009. All CO Approval conditions (1 April 2008) are addressed in this profile and the customer file.</p> <p>Initial date of activation was 1 January 2001, relationship ended and deactivated on 2 February 2005 due to TF issues (see Section VIII AML under Reputational Risk controls) as agreed with</p>
---------------------------------	---



Know Your Customer: AL RAJHI BANKING &amp; INVESTMENT CORP

	<p>AML Compliance New York. However this bank had a long-standing 25+ years relationship with Banknotes, London until that time. Also this client still has relationships with HSBC in the UK, UAE, France, Hong Kong and Italy. Approved as a London Banknotes customer 4 December 2005 after TF issues were cleared through AML Compliance New York.</p> <p>Now have a subsidiary of the Bank in Malaysia. Have obtained a licence to open in Kuwait, although no evidence found that this has happened yet.</p>
--	--

## II. Ownership/Management/Business Information

* Name of Principals or Beneficial Owners: (List all shareholders with 10% or more ownership. If Corporate Client not publicly traded, Special Category Client or High Risk Country, then list all shareholders with 5% or more ownership.)	* % of ownership:
Lehman Al Rajhi	24.90
Saleh Abdul Aziz Al Rajhi	13.90
Abdullah Abdul Aziz Al Rajhi	5.90
General Organization for Social Insurance	9.90
Publicly held (<5% shareholder)	45.40
Name of Corporate Officers:	Title:
	(e.g. Chairman, Vice/Deputy Chairman, President, Chief Executive Officer, Chief Financial Officer, and those Members of the Board or others with direct influence over the operations of the entire organization)
Sulaiman Abdul Aziz Al Rajhi	Chairman & Managing Director
Abdullah Sulaiman Al Rajhi	CEO
Saeed Mohammed Al Ghamdi	Deputy CEO
Iain Blacklow	COO
Mohammed Lookman Samsudeen	General Manager, Group CFO
Total Number of Employees:	5,777
Where is the Client incorporated:	SAUDI ARABIA
Year Established:	1988
What is Client's Rank in country (asset based):	2
How many branches/offices does Client have:	6 central offices, 694 branches
Where are the branches/offices located:	Saudi Arabia (subsidi has 18 in Malaysia)
Products/services sold:	Banking
For Foreign Financial Institutions only, indicate nature of Client's business (select all that apply):	Private Banking, Commercial/Retail Banking, Other
	Please describe: Islamic Banking (Sharia)
Client's Types of Customers:	General public
Locations of Client's Customers:	Saudi Arabia
Number of Client's Customers:	n/a
Do any of the Client's customers represent a significant % of its business?	<input type="radio"/> Yes <input checked="" type="radio"/> No
For each beneficial owner indicate:	The Al-Rajhi Family
Source of Wealth:	Banking
Approximate Net Worth:	USD 22.5 Billion
Occupation or Business:	Banking
Position or Title:	Various Senior Positions held
Business Name:	Al Rajhi Banking & Investment
Business Address:	Alakanya Building, Olaya St. 11411, Riyadh
Indicate reporting agency or supervisory/regulatory body (ies) in the country(ies) of operation:	SAMA - Saudi Arabian Monetary Agency
* List license type:	* Year of Issuance: * Country of Issuance:
ISLAMIC BANKING LICENSE	1988 SAUDI ARABIA
Is Client's Shareholders' Equity 25 Million USD or more?	<input checked="" type="radio"/> Yes <input type="radio"/> No

01/23/2012 02:13:18 PM

Page 3

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HSBC-PSI-PROD-0102312

Know Your Customer: AL RAJHI BANKING &amp; INVESTMENT CORP

Has the Client been under the same ownership for last 10 years (or 5 years if in a High Risk Country)?	<input checked="" type="radio"/> Yes <input type="radio"/> No
Is the Client or its Parent State-Owned? (Answer "Yes" if the government has the largest ownership percentage)	<input type="radio"/> Yes <input checked="" type="radio"/> No
Please list principal affiliates which have relationships with HSBC:	n/a
If the Client or affiliates have other Accounts with HSBC entities, provide the country in which each account is located:	Relationships with HSBC in the UK, France, Hong Kong and India.

## III. Referral Information

How was the Client introduced to the bank?	Long-standing relationship with Republic since 1970s.
By whom:	n/a
Is a GfI form or a CIBM KYC Profile from a referring office in the Client file? (If the client was referred from another HSBC entity/office)	<input checked="" type="radio"/> Yes <input type="radio"/> No
Global Relationship Manager (GRM) or Country Relationship Manager (CRM) recommendation received and in Client file?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, name of GRM or CRM:	Shamzad Bin Md Hussain
If yes, date:	01/26/2010
Name of Sales/Marketing/Trading person assigned to Client:	Banknotes team
Name of Relationship Manager (RM) for KYC Approval:	Christopher Lok

## IV. Visitation

## General Visitation:

Was a Client Site Visit performed?	<input checked="" type="radio"/> Yes <input type="radio"/> No
------------------------------------	---

## Visitation Details:

	Most Recent Site Visitation:	Prior Site Visitation:
Date of visitation:	01/20/2010	11/14/2009
By Whom:	Hathem Katerji, Director FIG	David Illing
Purpose - Banking Products/Services discussed:	M&A Strategy	Banknotes
Is call report in Client file?	<input checked="" type="radio"/> Yes <input type="radio"/> No	<input checked="" type="radio"/> Yes <input type="radio"/> No
Comments - provide other details regarding visitation (e.g., Client contact name and title, documentation reviewed):	Nikolas Fotilas, Head of Strategy	Ahmed Baghazal, Senior Dealer

## V. Purpose/Nature of Activity

Transactions *	Expected Frequency	Transactions *	Expected Frequency
ACH (Clearing House)		Money Market	
ARP (Account Reconciliation)		Securities Lending	
Asset Management		Swaps	
Check Collection (Cash Letter)		Swap Overnight Investment	
Checks/Demand Drafts		Time Deposits	
Clearing (Funds Transfer)		Trading - Banknotes *	See Banknotes Activity Section
Commercial Line		Trading - Bonds	
Commitments		Trading - Derivatives	
Control Disbursement		Trading - Emerging Markets	
Current Account		Trading - Equities	
Derivatives		Trading - Fixed Income	

01/23/2012 02:13:18 PM

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Confidential Treatment Requested

HSBC-PSI-PROD-0102313

Know Your Customer: AL RAJHI BANKING &amp; INVESTMENT CORP

Factoring		Trading - Foreign Exchange	
Forward Rate Agreements		Trading - Futures	
Globalization		Trading - Securities (Treasury)	
Guarantees (CD offset, Deposits)		Trading/Lending - Precious/Base Metals	
Intra Day Exposure Limit		Zero Balance Account	
Letters of Credit / Bankers Acceptances			
Loans			
Lockbox		Other:	

\* Refer to Client's file for anticipated volume of activity.

Managing for Value - Client's Profitability for HSBC (Annualized revenue - actual or anticipated, in USD equivalent) This is required for all PCM clients	
Indicate HSBC office where Banknote transaction activity will be conducted?	Hong Kong, London

## VI. Financial Summary

All financial data reported below should be in USD equivalent for comparison purposes globally. (a.g., no non-USD currencies and denominated in actual USD dollars)	
Financial Statement date:	12/31/2009
Currency (Local):	SAUDI RIYAL
Exchange rate (per USD):	3.750210
Denomination:	Actual
Assets:	45,525,378,312
Shareholders Equity:	7,663,806,560
Net Income:	1,804,493,082

## VII. Documentation Checklist

List of Authorized Signatories and/or Corporate Resolution in Client file?	<input checked="" type="radio"/> Yes <input type="radio"/> No
Current Annual Report (Form 10-K) or Financial Statement in Client file?	<input checked="" type="radio"/> Yes <input type="radio"/> No
Indicate Banking References and Relationship (List 3) (Name, Country, Date and Relationship):	CIBM KYC, France, 31 July 2006 CIBM KYC, UAE, 19 November 2007
Is banking reference documentation in Client file for Clients located in High Risk Countries?	<input checked="" type="radio"/> Yes <input type="radio"/> No

## Bank Client and Not a Central Bank

Copy of Banking License in Client file?	<input checked="" type="radio"/> Yes <input type="radio"/> No
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## Foreign Bank Client and Not a Central Bank

Is a USA Patriot Act Certification on file?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, date received by HSBC:	02/14/2009
If yes, date most recent Certification or Re-Certification was executed/signed by customer? (required by US Treasury every 3 years)	05/12/2009

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## VIII. Summary of Reasons

We have reviewed the information provided above in the context of the bank's "Know Your Customer" policy and "due diligence" requirements and criteria. Based on the following summary of reasons, we feel comfortable recommending this client for banking business.

**Purpose - Explain the purpose of the account / Client relationship and summarize the anticipated activity:**

Banknotes Trading - Please refer to the KYC Banknote Profile for a description for the reason for dealing in banknote transactions.

11 August 2010 - ALE search conducted on the bank, its management and owners. No matches were found on OFAC, World-Check listed one of the Board of Directors as a PEP and this has been noted below

EDD ROF dated 10 March 2010 contained some negative news articles concerning the bank's alleged refusal to cooperate with a US Government Supra in relation to its "investigation into terrorist financing". The bank has launched counter-proceedings in the US Courts in response to the US Government's stance. This case is currently pending an outcome and the US Government has yet to take any steps to make this a designated entity. London Banknotes has discussed these news articles with the GRM, who is comfortable with continuing this relationship. Until further developments London Banknotes is comfortable to continue the existing relationship, whilst monitoring the situation as is warranted for this SCC Type 4 client.

EDD ROF request made 13th January 2009. Compliance says not required from NY. Own due diligence performed and no issues found. No references were found to the history involving court cases.

EDD ROF 4th December 2007:

Despite the overall reputation of the Al-Rajhi family in Saudi Arabia, there have been numerous allegations of impropriety in the business dealings of Al-Rajhi and their group of companies, specifically in Europe and the United States. The controversy primarily centers around the patriarch, Sulaiman Bin Abdulaziz Al-Rajhi and somewhat directly and indirectly to Al-Rajhi Bank, of which he is both Chairman and Managing Director. These allegations allude to tax evasion, money laundering and terrorist financing. Though severe in nature, none of these allegations have yet resulted in any convictions or sanctioned by either U.S. or foreign governments. This bank is already rated an SCC-1 due to the ownership and control by Abdullah Abdul Al Rajhi. The KYC Customer profile indicates the various allegations against the bank but it is noted that no formal charges have been levied by US officials. We will leave this bank as a SCC-1.

**Ownership - Comment on the owner's / principal's background, history and reputation:**

Three Al Rajhi brothers own 44.5% of the shares in the Bank, although the total Al Rajhi family shareholding is significantly higher. Four Al Rajhi brothers are listed in Forbes Magazine as being part of the 400 wealthiest individuals in the world, with a combined net worth of \$22.5 Billion. No mention is made in Forbes about any connections to terrorist financing or terrorism for that matter. Apart from the General Organization for Social Insurance no portion of the remaining 45.4% is held by an individual or entity with more than 5% share. The founding Al-Rajhi family continues to hold a key stake and provides several of the top managers. It is the largest Islamic bank in the Arab world. Al Rajhi Banking and Investment Corporation is a major name in Saudi Arabia's banking and business world. It has grown from a strong base, focusing on serving the needs of the nation and its citizens, contributing to the Kingdom's construction and development, and always operating within the framework of Shariah principles. Al Rajhi Banking and Investment Corporation is one of the largest joint stock companies in the Kingdom, with a paid up capital of SR 2,250,000,000. Head Office is located in Riyadh and there are six Regional Offices. The Corporation has the largest branch network distributed throughout the Kingdom and the largest ATM network.

**Management - Comment on the Client's professionalism, expertise, experience, and education of senior officers / executives:**

The following Board of Directors and managers were checked against OFAC and World-Check as at 14 January 2009. No adverse information was found in the databases or on OFAC. London Banknotes believes that the management is competent as assessed by our meeting with management since 1998.

**Board of Directors:**

Sulaiman Abdul Aziz Al Rajhi - Chairman & Managing Director  
Abdullah Sulaiman Al Rajhi - CEO  
Sulaiman Saleh Al Rajhi  
Abdullah Abdul Aziz Al Rajhi  
Saleh Ali Aba Al Khail (PEP)  
Abdul Aziz Khalid Al Ghafaily  
Mohammed Osman Al Bishr  
Mohammed Abdul Aziz Al Rajhi  
Mohammed Abdullah Al Rajhi  
Ali Ahmed Al Shudy  
Saeed Omer Qasim Alesayi

**Management Team:**

Abdullah Sulaiman Al Rajhi - Chief Executive Officer of the Al Rajhi Bank. He is a member of a well-known business family in the

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Middle East and the Gulf Area. He is a graduate in Business Administration. He was the Deputy General Manager for Investments & Foreign Relations. During 1994 he was promoted to First Deputy General Manager and he became Director & General Manager of the Bank in 1996. In 2005 he was further promoted to the CEO of the bank. He is also a member of the Board of Directors of a group of other Saudi Business entities. He was nominated two times as the winner of The Islamic Banker of the Year Award 2007.

Saeed Mohammed Al Ghamdi - Deputy CEO for Al Rajhi Bank. With over 16 years of banking experience, Saeed has held several key positions with Al Rajhi Bank including Chief Information Officer, General Manager of IT & Operations before becoming Head of Retail Banking in 2003. Saeed assumed his current role of DCEO in 2007 and in his previous role as GM of Retail Banking, Saeed was responsible for leading projects across the retail business, including major projects in the areas of IT and CRM development.

Iain Blacklaw - COO. Mr Blacklaw joined Al Rajhi Bank as Chief Operating Officer in July 2008, in this role he has responsibility for the IT, Operations and Administrative Services. Iain has over 20 years of experience in Banking and IT Service Management, having held senior positions with EDS, Westpac Bank and Bank of Queensland in Australia, with a successful track record of implementing major change initiatives. At EDS Iain was responsible for all operations across Asia for EDS clients, in the Bank of Queensland he held the position Group Executive IT and Operations and at Westpac he built and ran the majority of the Bank's operations centres. Iain holds an Honours Degree in Economics from Aberdeen University, a qualified accountant (CIMA), obtained whilst working in London in the Oil industry and attended Stanford University for post graduate studies.

Dori Anand GM, Retail Banking Group. Anand was appointed General Manager of Retail Banking in July 2007. His is responsible for shaping the short and long term strategy for the Retail Banking Group. Anand has been with Al Rajhi Bank since August 2003. Prior to his current assignment Anand held senior management roles in the Consumer Asset business and Operations department within Al Rajhi Bank. Anand has 18 years of Retail Banking experience with exposure to banking practices in countries across the CEMA region. He has rich experience in setting up green field projects in banking which include new bank set ups, off shore outsourcing practices and banking affiliate set ups. Prior to joining Al Rajhi, he served as a Vice President in Citigroup, where he worked for 13 years. Anand holds an MBA degree with specialization in Marketing and Systems. He is also a member of Visa's Advisory Board for CEMA. Anand is married with 2 daughters.

Marin Lopez - General Manager of the Corporate Banking Group. Marin has over 23 years experience in the Corporate and Investment Banking field. Marin spent 18 years working with Citigroup where he held various management positions including, Head of Financial Institutions and Public Sector, Senior Credit Officer and Head of Corporate for Malaysia and Southern and Eastern Africa. Most recently whilst at Barclays, Marin headed up Merchant Banking for the Africa and the Middle East.

Constantinos (Dinos) Constantinides - General Manager for Strategy and has over 13 years of international experience gained in the financial services industry. His current responsibilities include the development of the Bank's business strategy, together with their transformation and execution into robust business plans. Previously, Dinos has supported the Bank in setting up and growing the Retail Banking Group both as an external consultant as well as a member of the executive team. Prior to joining Al Rajhi Bank Dinos' main professional experience was with Accenture where he led several strategic initiatives for European banks and financial institutions. Dinos holds an MBA degree, with a specialization in International Strategy from the University of Birmingham and is a graduate of the Economic University of Athens. Dinos is married with 3 children.

Saud Abdul Aziz Al Hoshan - General Manager for Human Resources. Joined Al Rajhi Bank in February 2008 as General Manager of Human Resources. Saud started his career as a Civil Engineer for about 6 years in the government, and later transitioned to Human Resources. He has over 25 years experience in many fields and industries. Prior to joining Al Rajhi, he served as a Vice President of Human Resources in Alsalam Aircraft Company. Saud has an MBA and B.S in Civil Engineering from Gonzaga University in Spokane, Washington State, USA. Saud is married with 1 son and 1 daughter.

Damien White - General Manager Treasury Group. Joined Al Rajhi Bank in January 2009 as General Manager of the Treasury Group. In his 20+ years of working experience Damien has held senior Treasury positions with the National Australia Bank Group and Lehman Brothers in addition to serving as an Officer with the Australian Army. Damien's focus in his current role is on building an international Treasury function with a full suite of Islamic Treasury products. Damien holds an MBA from the Melbourne Business School.

Saleh Abdullah Al Lhaidan - General Manager for the Sharia Group. He brings a wealth of experience to the Bank. Associate Professor in the Department of Comparative Jurisprudence at the Graduate Institute of Justice, he holds a PhD in comparative Jurisprudence from the High Institute of Justice. He worked in the Faculty of Sharia in Qassim in 1407 AH., and then in the Faculty of Sharia in Riyadh in 1412 AH, followed by a post as an assistant Professor in the Department of Comparative Jurisprudence at the High Institute of Justice in 1416 AH. Dr Saleh also worked in administration of the Higher Institute for Justice for two years, and as a member of the Institute for six years. He is also a member of the Scientific Council at the University.

#### Visitation - Summarize information obtained from Client visitations and discussions (Call Reports, etc):

20 January 2010 - Haithem Ketajji, Director FIG met with Nikolas Fotilas, Head of Strategy at Al Rajhi Bank

Met with Nikolas Fotilas on Wednesday 20th January, 2010. The purpose of the visit was to get an update on their M&A strategy for 2010 and run by them an opportunity in Turkey. The main focus for 2010 is organic growth where the bank is due to open branches in Kuwait (1 branch) and Jordan (8 branches). They will be very opportunistic on the M&A front and they are interested in GCC and Egypt. Turkey is not of interest as the Chairman is not convinced of the Islamic Banking proposition in the country. We agreed to stay in touch and have monthly calls or visits.

14 november 2009 - David Billing met with Ahmed Baghzaf, Senior Dealer

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Met with Ahmed at GTB roadshow in Riyadh.

He is very happy with the increased business we have done this year, especially now that we repatriate our surplus SAR notes to them. The recent order they had for £100 mio was fulfilled with Commerzbank who had no issues with the credit risk on the deal. Discussions took place in a later meeting about Al Rajhi opening a USD account with us in New York which would assist the Banknotes business.

2 March 2009 - Shamzani Bin Md Hussain met with Mohammad Fazal Haque, M Farshad Cader

Discussion Points:

- Announced USD 1.7 bn profit for 2008 - 4th Quarter 2008 profit was down 10% - YoY to 2007

- Expect 2009 to be more challenging

- Agreed that a lot more business can be done between the two institutions

- Requested for CAD clearing with HBCA asap

- To increase volumes of existing Banknotes business

- Pursuing Docs for Structured Investment Products

- To increase Brokerage transactions i.e. Metal Trading, once they get clarity on fee reduction

- Trade transactions - ready to channel business if rebates arrangement is agreed

- Requested HSBC for Bilateral Murabaha - 1-2 years tenor

- To build synergies with Al Rajhi Malaysia - immediate Treasury and Trade transactions + multi-currency platform

- Possibility for funding exercise by 4th quarter 2009 - either via Sukuk programme or Syndication - target USD 2.0bn EMTN - HSBC to be advised

Action:

- Shamzani to continue overall engagements to increase Flow business and secure potential EMTN mandate

- John / Salman to follow up on CAD accounts

- David Billings to follow up on Banknotes

- Sulaiman to revert on brokerage fee reduction and follow up on Treasury Docs

- Shamzani and Davies to follow up with Che Zam / Fadillah of Al Rajhi Malaysia's Treasury.

Shariq Siddiqi - 23rd June 2008:

Met with Mohammed Fazal Haque, Manager Financial Institutions. Mohammed mentioned they have received Canadian Dollar proposals from three other banks, and was asking if there is any update on our side. Apparently, he was not kept in the loop by his team on this issue. I told him that Al Rajhi had problems using our Agreement, and HSBC Canada had reservations against the Agency Agreement sent by them. I explained that if we have to use their Agreement, we need to go through a tedious clearance / approval process. It was agreed to close the issue one way or other by next week.

They would be interested in working with Amanah on deals at Senior level. Historically, the focus had been on Saudi market but they have now started looking at transactions outside the Kingdom as well. He said initial areas of interest would be infrastructure and FI exposures and they can come in transactions with USD100m and above. I told him we will certainly keep this in mind. With regards to their own funding, the USD1.0m 5-year facility discussed earlier is not likely to happen this year due to market conditions. They will revisit the issue next year. He was pleased with the relationship on banknotes side, and advised that Salah Al Jumal would be the best person to meet in that regard. I also expressed desire to broaden the contact with their product teams, and he will arrange meetings with asset management, structured finance etc during the next visits.

Shariq Siddiqi - 23rd July 2007:

Met with Mohammed Fazal Haque, Manager Financial Institutions. Al Rajhi Bank is majority owned by the members of Al Rajhi Family. Recently, Fahad Al Rajhi (GM for Treasury and FI) and Cassim Doucat (AGM for Treasury and FI) left the bank. We had requested for a meeting with Acting GM of Treasury and FI (Anand Anchan) and his team, but only the Acting Head of FI (Mohd Fazal Haque) along with his assistant turned up for the meeting. The bank has strict KYC Policies and monitors any unusual transactions through accounts as well as reporting to the SAMA (Saudi Arabian Monetary Agency). Upon opening an account, customers must provide sufficient information about themselves to satisfy the bank. Money laundering is not considered to be a major problem in Saudi Arabia due in part to the extremely severe penalties for drug related crimes.

They advised that it has been Al Rajhi's policy to primarily deal with the largest local bank in each country. As regard to their correspondent banking relationship in Sudan, they confirmed that the main correspondent is Bank of Khartoum, which also maintains a GBP account with HSBC London. Raju confirmed that relationship with other Sudanese banks is either inactive or insignificant. He also advised that the bank is reviewing its overall relationship portfolio with a view to close the dormant inactive accounts. The bank confirmed that it fully understands the risks associated with providing financial services or making funds available to listed terrorists/sanctioned names notified by the competent authorities. He confirmed that necessary due diligence based on FATF/SAMA guidelines is performed at the relationship inception stage. They have an automated process to detect if the client appears on the list of SDN/sanctioned names advised by the regulatory authority. It also has a transaction monitoring system to detect unusual activity in the account and provides daily reports, which are reviewed by compliance. If there is suspicion about an account, it is immediately reported to SAMA and the account is put under surveillance. If it is established that the account is indeed being used for money laundering purposes, the relationship is immediately exited.

Simon Putt, Hissam Karmal - 19th March 2007:

Met with Anand Anchan, AGM, Treasurer; Samer Farhoud, Deputy Treasurer and Abdulaziz Al Amro, Senior Manager - Head of Products. Meeting to pitch a rated international Sukuk issue by Al Rajhi Bank. They were very open that they would very much like to issue along the lines of ADIB and Shajiah Islamic Bank, and that although they are highly liquid, they would do it tomorrow for strategic purposes.

Salman Hussain, Pallavi Kempalath - 19th July 2006:

Met with Mohammed Fazal Haque, Manager Financial Institutions and Mohammed Ashraf. Cassim Doucat (head of Financial Institutions) was attending the ADB Conference in Hyderabad, hence MH filled in for him. MH apprised us that the Org was being

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revamped with focus moving to new areas like corporate banking apart from consolidation in the retail sector.

Mastair Muir, Nigel Weir, Emran Alireza (in London) - 23rd January 2006:  
Bank Notes - they currently buy 75-100m per month of mainly dollar notes and use Commerzbank for this service they also occasionally buy other European currencies and are interested in opening up a dialogue. The new treasurer Anand is the contact +966 1 211 6000. Met with Cassim Doctat, AGM Head of Financial Institutions. He was formerly with BIB in Bahrain and for the last two years has been working out of Canada for the Islamic Development bank. He was offered and accepted a job with Al Rajhi in May 2005. He reports into Fahad Abdullah Al Rajhi, who is head of Treasury & Financial Institutions and was also due to attend this meeting but was delayed in Switzerland. He estimates that as a bank they are responsible for transaction values in the region of USD 12 billion per annum and believes this represents a substantial piece of business for the FI market and he is keen to share this around. He gives the impression of being keen to develop business with HSBC globally. They currently have 380 branches and around 5.5K staff. He has an area manager responsible for each region Europe, Asia and the Americas. Shariq should make contact with Cassim to introduce himself, he has not met many people from HSBC in the last 9 months in his role. Treasury - Colin Willis is no longer Head of Treasury and is on a special project and been replaced by Anand Anchan. Colin favoured certain institutions and HSBC was not one of them and the former head of FI Mr Raju and Colin did not communicate.

Does the Client have KYC and Anti-Money Laundering (AML) policies and procedures documented?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, has a copy been filed in the Client file? (Required if Client is in a High Risk Country.)	<input checked="" type="radio"/> Yes <input type="radio"/> No
Does the Client's KYC and AML Policies and Procedures require identification documentation and verification when opening an account?	<input checked="" type="radio"/> Yes <input type="radio"/> No
Does the Client have a screening process regarding the procedures for the establishment of new accounts, (including obtaining information on the source of funds)?	<input checked="" type="radio"/> Yes <input type="radio"/> No
Does the Client offer accounts or services to anonymous customers?	<input type="radio"/> Yes <input checked="" type="radio"/> No
Does the Client have an ongoing system in place to monitor and report suspicious activity?	<input checked="" type="radio"/> Yes <input type="radio"/> No
What are the procedures when unusual transactions are detected as a result of the Client's ongoing monitoring process?	Unusual customer activity is monitored through their AML automated monitoring system (PRISM-ACI) by establishing rules which generate daily alerts in line with FATF recommendations. Suspicious activity is reported to management and then to the AML unit (AML Reporting Officer currently Mr Ali Al Sufyan). It is reported to the local authorities (Anti Financial Crimes Unit - Saudi FIU), as well as sending a copy to SAMRA (Saudi Arabian Monetary Agency).
How are the Client's KYC and AML Policies and Procedures communicated and enforced in the Client's network of domestic and foreign offices?	Communicated through circulars, training seminars. AML unit enforces Policies and Procedures.
Does the Client have a formal / independent Anti-Money Laundering Compliance function?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, does the Client provide Anti-Money Laundering Training to its employees?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, how often is this AML training provided and to whom?	All new bank staff receive AML/TF training. All Managers, Controllers, Operations and Counter Staff receive AML Training annually.
Comment on the Client's KYC and AML practices (past, present and/or future).	The Compliance Officer has supplied by email a copy of their AML Policy (in English) which was issued July 2006. The bank also provided us with the 56 page document giving detailed rules on AML from SAMRA and confirmation that they comply with these. In summary, the information provided by the customer covers all areas of AML requirements.  No banking services are provided to new customers without proper identification. The bank requests information on our customer's source of cash so that a reasonable understanding of the profile of the customer is obtained. Customer records and documents are maintained for at least 10 years from the date of origination of the record or document or, in the case of Account Opening documents and Customer identification records, 10 years from the date the Customer closes his account.  An Anti-Money Laundering Unit (AML Unit) is established within

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	<p>their Internal Audit. Staff is required to alert their manager if they suspect money laundering. The AML Unit will the scrutinise the account of the Customer under suspicion of money laundering and, if warranted, alert SAMA and the authorities.</p> <p>A copy of their extensive rules governing SAMA's Anti Money Laundering and Terrorist Financing is held on client file in London. Saudi Arabian Monetary Agency (SAMA), the Central Bank of the Kingdom of Saudi Arabia, was established in 1952. They issue national currency, the Saudi Riyal.</p> <p>act as a banker to the government; supervise commercial banks; manage Kingdom's foreign exchange reserves; conduct monetary policy for promoting price and exchange rate stability, and promote the growth and ensures the soundness of the financial system.</p>
<p>Does the Country the Client is located in have KYC and AML laws and regulations?</p>	<p><input checked="" type="radio"/> Yes <input type="radio"/> No</p>
<p>If yes, comment on the country's KYC and AML practices (past, present and/or future) regarding prevention of money laundering and terrorist financing.</p>	<p>Extract from 2009 International Narcotics Control Strategy Report (INCSR)</p> <p>The Kingdom of Saudi Arabia is a growing financial center in the Gulf Region of the Middle East. However, there is no indication that narcotics-related money laundering currently is vulnerability in the country. Saudi Arabia is neither a major center within the region for financial crimes nor an offshore financial center. Saudi officials acknowledge difficulty in following the money trail due to the preference for cash transactions in the country. Money laundering and terrorist financing are known to originate from Saudi criminal enterprises, private individuals, and Saudi-based charities. There is an absence of official criminal statistics, but reportedly, there was no significant increase in financial crimes during 2008. It is believed the proceeds of crime from stolen cars and counterfeit goods are substantial. All eleven commercial banks in Saudi Arabia operate as standard "Western-style" financial institutions and are under the supervision of the central bank, the Saudi Arabian Monetary Agency (SAMA). In 2003, Saudi Arabia approved a new Anti-Money Laundering Law that contains criminal penalties for money laundering and terrorist financing. The law bans conducting commercial or financial transactions with persons or entities using pseudonyms or acting anonymously; requires financial institutions to maintain records of transactions for a minimum of ten years; adopts precautionary measures to uncover and prevent money laundering operations; requires banks and financial institutions to report suspicious transactions; authorizes government prosecutors to investigate money laundering and terrorist financing; and, allows for the exchange of information and judicial actions against money laundering operations with countries with which Saudi Arabia has official agreements.</p> <p>In May 2003, SAMA issued updated anti-money laundering and counterterrorism finance guidelines for the Saudi banking system in accordance with the Financial Action Task Force's (FATF) 40 Recommendations on Money Laundering and the Nine Special Recommendations on Terrorist Financing.</p> <p>In June 2007 the GOSA enacted stricter regulations on the cross-border movement of money, precious metals, and jewels.</p> <p>The new 2007 regulations also stipulate that whoever is convicted of money laundering will be imprisoned for up to ten years and fined up to five million Saudi riyals (approximately \$1,333,300). The regulations also state, "Whoever funds terrorists or terror organizations is considered to be committing a crime of money laundering."</p> <p>Saudi Arabia participates in the activities of the FATF through its membership in the Gulf Cooperation Council (GCC), and as a member of the Middle East and North Africa Financial Action Task Force (MENAFATF). Saudi Arabia will be undergoing a second</p>

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	<p>FATF mutual evaluation in February 2009. Saudi Arabia is a party to the 1988 UN Drug Convention, the UN Convention against Transnational Organized Crime, and the UN Convention for the Suppression of the Financing of Terrorism. Saudi Arabia has signed but not ratified the UN Convention against Corruption.</p> <p>The Government of Saudi Arabia is taking steps towards enforcing its anti-money laundering/counterterrorist finance laws, regulations, and guidelines. However, Saudi Arabia continues to be a significant jurisdictional source for terrorist financing worldwide. The GOSA continues to take aggressive action to target direct threats to the Kingdom, but could do more to target Saudi-based support for extremism outside of Saudi's borders. Saudi authorities should hold terrorist financiers publicly accountable through prosecutions and full implementation of UNSC obligations. The GOSA also needs to take concrete steps to establish a charities oversight mechanism that also oversees "multilateral organizations" and enhances its oversight and control of Saudi entities with overseas operations. Charitable donations in the form of gold, precious stones and other gifts should be scrutinized. There is still an over-reliance on suspicious transaction reporting to generate money laundering investigations. Law enforcement agencies should take the initiative and proactively generate leads and investigations, and be able to follow the financial trails wherever they lead. The public dissemination of statistics regarding predicate offenses and money laundering prosecutions would facilitate the evaluation and design of enhancements to the judicial aspects of its AML system. Saudi Arabia should become a party to the UN Convention against Corruption.</p> <p><a href="http://www.state.gov/p/in/lrfs/mrcrpt/2009/vol2/116545.htm">http://www.state.gov/p/in/lrfs/mrcrpt/2009/vol2/116545.htm</a></p>
Sources used for Country KYC, supervisory regime and AML information are set out in the HSBC AML Country Risk List. Please refer to the KYC User Guide.	

Has the Client been audited?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, date:	01/30/2010
If yes, by whom (Audit Firm):	Ernst & Young - PriceWaterhouseCoopers Al Juraid
Does the Client have a credit rating?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, who issued it (S&P, Moody's or other):	Fitch
If yes, date issued:	03/08/2010
If yes, credit rating:	A- (long-term) F1 (short-term)
Employing reasonably available information, has due diligence been conducted on the Client's AML record?	<input checked="" type="radio"/> Yes <input type="radio"/> No
Has negative information been identified?	<input checked="" type="radio"/> Yes <input type="radio"/> No
Specify how the reputational risk is being controlled:	<p>A multitude of allegations have surrounded the Al-Rajhi family implicating them in a gamut of highly adverse activities ranging from money laundering to terrorist financing. The current facts, however, do not easily support these allegations. Presently, no U.S. or foreign government law enforcement or regulatory body has stated, unconditionally, that any member of Al-Rajhi or any company controlled by Al-Rajhi is under sanction. The U.S. continues to pursue relationships with Saudi Arabia and the Al-Rajhi family regardless of the allegations being levied against charitable institutions with some presumably direct and indirect links to Al-Rajhi. The major 9/11 lawsuit, which included Al-Rajhi, has been dropped against the family and family-related institutions.</p>

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However, there is some reputational risk and the possibility that further investigations by U.S. authorities may ultimately uncover substantiating proof of the Al-Rajhi connection to terrorism is certainly a concern. Our account relationship with Al-Rajhi will be adversely affecting USD banknotes out of London. The risk of future sanctions and the reputational risk based on the aforementioned allegations should be measured against the current risks involved in our relationship when ultimately deciding our course of action. Therefore, London Banknotes feels that the bank poses minimal reputational risk to us. The senior management of the bank is fully aware of the previous issues that caused our relationship to be under review and understand we have to abide by United States banking and regulation. They have agreed to advise us in advance in market and customer type of USD banknote business, whenever it occurs. Given that the bank operates its banknotes operations internally only, coupled with the fact that this relationship is categorized an SCC, and the other management team will feel that we can reactivate this relationship.

Has Enhanced Due Diligence been conducted for this High Risk Client/Country, which includes Compliance (ICRO) checking OFAC & public databases for the names of the customer, principals/beneficial owners, and executive officers?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, has Compliance confirmed that there is no direct adverse information to preclude business with this client?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, date:	08/09/2010
Date of most recent KYC review:	08/11/2010
Department of the Account Manager / Administrator (AM) who prepared this profile:	Banknotes Trading

## Signature Section

Account Manager / Administrator (AM) Approval:	Denise HOLDER 16/08/2010 15:11
Client Services / Manager (CS) Approval:	Stephen J ALLEN 17/08/2010 13:10
Functional Head of Business / Executive (IS) Approval:	David M Wilens 08/17/2010 10:22 AM
Relationship Manager (RM) Approval:	Not Required
Institutional Banking / Team Leader (IB) Approval:	Christopher Lok 08/18/2010 03:32 PM
Regional Money Laundering Control Officer (CO) Approval:	

## APPROVE/DENY HISTORY:

Created: 05/29/2001 10:20:13 AM Converted from Epic

05-23-2001 14:28 PM Created by: &lt;EPIC to KYC Conversion Process&gt;

&lt;Address&gt;

P.O. BOX 28  
RIYADH 11411  
SAUDI ARABIA

<Status> A - Approved  
<Client Name> AL RAJHI BANKING AND INVESTMENT CORPORATION  
<Acct\_off\_code> 343141  
<Acct\_offr>  
<Approval\_acct\_officer> \*\*\* Mouzannar, Joe \*\*\* 4/9/98 16:04:00 276  
<Unit\_offr\_code> 343137  
<Unit\_mgr>  
<Approval\_unit\_mgr> \*\*\* Baba, Fawaz \*\*\* 4/9/98 17:27:09 773  
<Exec\_dept>

01/23/2012 02:13:18 PM

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Confidential Treatment Requested

HSBC-PSI-PROD-0102321

Know Your Customer: AL RAJHI BANKING & INVESTMENT CORP

<Approval\_exec\_dept> :  
 <Legal\_dept> :  
 <Approval\_legal\_dept> :  
 <Legal\_dep\_comments> :

In Process: (Old Status Approved), 08/15/2002 02:25 PM: Sharyn Malone

Purpose of account changed from: [ ] to: [USD Clearing]  
 License Country(1) changed from: [ ] to: [SAUDI ARABIA]

AM Approved: (Old Status In Process), 21/01/2004 12:08: Anna T BROBERG  
 No Comments

CS Approved: (Old Status AM Approved), 21/01/2004 12:19: Stephen J ALLEN  
 No Comments

IS Approved: (Old Status CS Approved), 01/21/2004 05:34 PM: Christopher Lok  
 No Comments

IB Denied: (Old Status IS Approved), 02/19/2004 04:26 PM: Beth Fisher  
 Pls remove Beth Fisher's name as RM for this bank. HBUS NYK CIB RMs have never met this bank. Since this is an SCC, an RM is not in the approval chain on the Notes system. If an RM name is needed, we suggest to input the Banknotes Product RM - or an RM in the Middle East who is familiar with the bank.

AM Approved: (Old Status IB Denied), 20/02/2004 09:01: Anna T BROBERG  
 No Comments

CS Approved: (Old Status AM Approved), 20/02/2004 09:13: Stephen J ALLEN  
 No Comments

IB Approved: (Old Status IS Approved), 03/16/2004 12:10 PM: Brian Robertson  
 No Comments

CO Denied: (Old Status IB Approved), 11/09/2004 04:51 PM: Teresa Pesce  
 No Comments

AM Approved: (Old Status CO Denied), 11/01/2005 17:30: Sally G LOMAS  
 Profile updated

CS Approved: (Old Status AM Approved), 12/01/2005 08:33: Stephen J ALLEN  
 No Comments

IS Approved: (Old Status CS Approved), 01/27/2005 11:22 AM: Christopher Lok  
 I would ask for conditional approval for another 6 months as to date despite negative news report no official commencement of investigations have commenced. If and when reliable info pointing to this client not appropriate for our business relationship we can then terminate immediately.

IB Approved: (Old Status IS Approved), 01/28/2005 06:11 PM: Timothy Waring  
 No Comments

CO Denied: (Old Status IB Approved), 02/02/2005 10:14 AM: Lynda J Cassell  
 Denied at the request of Daniel Jack

AM Approved: (Old Status CO Denied), 14/11/2006 17:26: Gordon BROWN  
 Reactivating customer, ready for KYC reapproval process.

CS Approved: (Old Status AM Approved), 14/11/2006 17:35: Stephen J ALLEN  
 No Comments

IS Approved: (Old Status CS Approved), 11/14/2006 02:13 PM: Christopher Lok  
 No Comments

IB Denied: (Old Status IS Approved), 11/17/2006 09:20 AM: Beth Fisher  
 Please remove my name as RM. I do not know this bank.

AM Approved: (Old Status IB Denied), 04/12/2006 14:08: Gordon BROWN  
 RM approval changed to Christopher Lok, ready for KYC approval process.

CS Approved: (Old Status AM Approved), 04/12/2006 14:13: Stephen J ALLEN

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Confidential Treatment Requested

HSBC-PSI-PROD-0102322

Know Your Customer: AL RAJHI BANKING & INVESTMENT CORP

No Comments

IS Approved: (Old Status CS Approved), 12/04/2006 02:33 PM: David M Wilens  
No Comments

IB Approved: (Old Status IS Approved), 12/04/2006 03:07 PM: Christopher Lok  
No Comments

Approved: (Old Status IB Approved), 12/04/2006 04:44 PM: Alan T Kadey  
Approval is given for Banknotes business - If PCM business is added at some future date it must not include cash letter or demand drafts. Should a PCM relationship commence, senior PCM management should approve it in writing.

In Process: (Old Status Approved), 06/02/2008 11:48: Christopher BAYLISS

Name of principals changed from: [Sulaiman Abdul Aziz Al Rajhi, Saleh Abdul Aziz Al Rajhi, Mohammed Abdul Aziz Al Rajhi, Abdullah Abdul Aziz Al Rajhi (four brothers control 57%), Publicly held (<5% shareholder)] to: [Sulaiman Abdul Aziz Al Rajhi, Saleh Abdul Aziz Al Rajhi, Abdullah Abdul Aziz Al Rajhi (three brothers control 44.5%), General Organization for Social Insurance, Publicly held (<5% shareholder)]  
Ownership percentage changed from: [57.43] to: [24.7,13.7,6.1,10.45,5]

AM Approved: (Old Status In Process), 26/03/2008 12:03: Gordon BROWN  
KYC review completed, ready for reapproval process.

CS Approved: (Old Status AM Approved), 26/03/2008 12:22: Stephen J ALLEN  
No Comments

IS Approved: (Old Status CS Approved), 03/26/2008 04:38 PM: David M Wilens  
No Comments

IB Approved: (Old Status IS Approved), 03/26/2008 04:43 PM: Christopher Lok  
I fully support re-activating this account while we will diligently monitor the account's performance.

Approved: (Old Status IB Approved), 04/01/2008 05:42 PM: Alan P Williamson  
AML risk should be discussed in visitation/call report, including whether MSB payout agent. Note that like prior approval, this is limited to banknotes only

In Process: (Old Status Approved), 26/01/2010 13:40: Denise HOLDER

Name of principals changed from: [Sulaiman Abdul Aziz Al Rajhi, Saleh Abdul Aziz Al Rajhi, Abdullah Abdul Aziz Al Rajhi (three brothers control 44.5%), General Organization for Social Insurance, Publicly held (<5% shareholder)] to: [Lehman Al Rajhi, Saleh Abdul Aziz Al Rajhi, Abdullah Abdul Aziz Al Rajhi, General Organization for Social Insurance, Publicly held (<5% shareholder)]  
Ownership percentage changed from: [24.7,13.7,6.1,10.45,5] to: [24.9,13.9,5.9,9.9,45.4]

AM Approved: (Old Status In Process), 08/03/2010 07:51: Denise HOLDER  
Temporary AM approval to allow HK to update their BN page

CS Denied: (Old Status AM Approved), 08/03/2010 11:02: Stephen J ALLEN  
No Comments

AM Approved: (Old Status CS Denied), 12/04/2010 09:22: Denise HOLDER  
Temporary AM approval to allow the London BN page to be updated

CS Denied: (Old Status AM Approved), 12/04/2010 09:36: Stephen J ALLEN  
denied as requested by DH

AM Approved: (Old Status CS Denied), 16/08/2010 15:11: Denise HOLDER  
No Comments

CS Approved: (Old Status AM Approved), 17/08/2010 13:10: Stephen J ALLEN  
No Comments

IS Approved: (Old Status CS Approved), 08/17/2010 10:21 AM: David M Wilens  
No Comments

IB Approved: (Old Status IS Approved), 08/18/2010 03:32 PM: Christopher Lok  
No Comments

CO Denied: (Old Status IB Approved), 09/09/2010 08:58 AM: Joanna S Flanagan  
business being exited

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Confidential Treatment Requested

HSBC-PSI-PROD-0102323

Know Your Customer: AL RAJHI BANKING &amp; INVESTMENT CORP

Revision History		
Editor	Date	Reason for Update
Denise HOLDER	15/10/2010 08:12:31	Profile Deactivated
Denise HOLDER	11/08/2010 09:31:47	Various updates - Financials, management, EDD ROF and ALE
Denise HOLDER	26/01/2010 13:48:10	Updated GRM support
Denise HOLDER	26/01/2010 13:40:24	Annual review - various updates
Denise HOLDER	01/12/2009 12:56:04	Updated financials, auditors report and call report
Denise HOLDER	15/09/2009 08:01:10	Updated p-cert
Denise HOLDER	15/04/2009 09:32:24	Updated Visitation
Denise HOLDER	02/03/2009 08:28:42	Added Hong Kong to HSBC Banknote Office
Denise HOLDER	23/01/2009 10:36:09	Updated EDD date
Sally G LOMAS	15/01/2009 12:23:01	GRM

CRR Revision History			
Last Updated By/ On	Update Type(Field/General)	Old Value	New Value
Denise HOLDER : 15/10/2010 08:12:36	epic_activityStatus	Active	Deactivated

— = Redacted by the Permanent Subcommittee on Investigations

## Know Your Customer Profile

HSBC Bank USA, N.A.

Version 7.0

Reference: [REDACTED] Client Profile Approval Status: In Process

Country Risk Status: High Risk

Needs Re-Approval

Client Name: Islami Bank Bangladesh Limited  
Country: BANGLADESH

\* Changes to these fields on "Approved" Profiles require Re-approval.

### I. General Information

Client Name: Islami Bank Bangladesh Limited	
Is this a Client of Global Payments and Cash Management (PCM in Delaware)?	<input checked="" type="radio"/> Yes <input type="radio"/> No
Is this a Client of Corporate and Institutional Banking (CIB)?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, CIB Industry:	Banks & Securities Companies
* Client Activity Status:	Active
* Client Category:	<input type="radio"/> Domestic Financial Institution <input checked="" type="radio"/> Foreign Financial Institution <input type="radio"/> Investment Advisor or Fund <input type="radio"/> Corporate Client <input type="radio"/> Sole Proprietor or Partnership
Type of Client:	<input checked="" type="radio"/> Bank <input type="radio"/> Non-Bank
Legal entity:	<input checked="" type="radio"/> Parent <input type="radio"/> Branch <input type="radio"/> Subsidiary
Is the Client a Central Bank?	<input type="radio"/> Yes <input checked="" type="radio"/> No
* Is Client a "Special Category of Client"? (Refer to Group Policy GCL 000074 on SOCs)	<input type="radio"/> Yes <input checked="" type="radio"/> No
Has the Client's name and location been checked against Government lists of known or suspected terrorists or criminals (e.g., OFAC and World-Check)? (This is to be completed for prospects only - existing clients are scanned monthly and when the OFAC list changes.)	<input checked="" type="radio"/> Yes <input type="radio"/> No
Address (Business / Permanent): (A PO Box alone is not sufficient for address.)	40, Dilkusha Commercial Area
City:	Dhaka, Bangladesh 1000
* Country:	BANGLADESH
Telephone:	+880 2 955 2616 +880 2 956 7162 +880 2 956 9147
Email address of Client contact:	[REDACTED]
Client's URL (Web Site):	www.islamiibankbd.com
Fax:	+880 2 956 4532 +880 2 956 8634
Swift Code:	ISBLBD0H

Permanent Subcommittee on Investigations  
**EXHIBIT #86**

Confidential Treatment Requested

HSBC-PSI-PROD-0117222

Know Your Customer: Islami Bank Bangladesh Limited

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Subcommittee on Investigations

<b>Taxpayer ID (EIN or SSN):</b> Pending <b>New Client or Existing Client:</b> <input type="radio"/> New (prospect) <input checked="" type="radio"/> Existing (active) <input type="radio"/> Agency Arrangements only <b>Account Number:</b> [REDACTED] <b>Date Account Activated:</b> 10/18/2000 <b>* Purpose of Account:</b> USD clearing Services Funds Transfer Clearing Account <b>Is the Client or its Parent traded on an Exchange?</b> <input checked="" type="radio"/> Yes <input type="radio"/> No <b>If yes, Name of Exchange:</b> Dhaka & Chittagong Stock Exchanges	
<b>CIP Verification of ID - Has the original customer identification/documentation been verified, as per USA PATRIOT Act regulations for new customers (or new accounts/locations for existing customers)? (Documentary and/or Non-Documentary evidence)</b> <input checked="" type="radio"/> Yes <input type="radio"/> No <b>Documentary Evidence for CIP:</b> (this may include banking license, registered articles of incorporation, partnership agreement, etc. - with more detail in Section VII) For the Banking License, indicate "Yes" if you have a copy of the license or a printout/screenshot from their Central Bank's website appropriately listing the client/bank. <b>If yes, was documentary evidence verified?</b> <input checked="" type="radio"/> Yes <input type="radio"/> No <b>If yes, type of document(s):</b> Banking License <b>Non-Documentary Evidence CIP:</b> (this may include financial statements, references, customer contact/visitations, Patriot Act Certification, company website, database searches, etc. - with more detail in other sections) <b>Was non-documentary evidence verified?</b> <input checked="" type="radio"/> Yes <input type="radio"/> No <b>If yes, indicate verification methods used:</b> Customer Contact/Visitation, Financial Statements, Third Party Source (eg Banker's Almanac), Banker's Almanac, Client's website & Stock Exchange, Regulator's Website Screenshot, Auditor's Report	
<b>General comments:</b> I. Company Overview ***** The establishment of Islami Bank Bangladesh Limited on March 13, 1983, is the true reflection of this inner urge of its people, which started functioning with effect from March 30, 1983. This Bank is the first of its kind in Southeast Asia. It is committed to conduct all banking and investment activities on the basis of interest-free profit-loss sharing system. In doing so, it has unveiled a new horizon and ushered in a new silver lining of hope towards materializing a long cherished dream of the people of Bangladesh for doing their banking transactions in line with what is prescribed by Islam. With the active co-operation and participation of Islamic Development Bank (IDB) and some other Islamic banks, financial institutions, government bodies and eminent personalities of the Middle East and the Gulf countries, Islami Bank Bangladesh Limited has by now earned the unique position of a leading private commercial bank in Bangladesh. <source: <a href="http://www.islambankbd.com/introduction.php">http://www.islambankbd.com/introduction.php</a> > II. Support Statement ***** GRM Support provided by Sadique Reza on 04/17/2011, "You have our support for the below mentioned relationship." III. Findings ***** EDD ROF requested 9/21/2009. Compliance denied responding, "I believe an updated EDD ROF is NOT needed at this time for this PCM client."	

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Know Your Customer: Islami Bank Bangladesh Limited

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EDD ROF 5/11/2006, a notice of cause was issued by the Bank of Bangladesh to the CEO of Islamic Bank in March 2006 to explain accounts owned by suspected Islamic Militants. Client was subsequently fined by Bangladesh Bank and take measures against 20 officers for their involvement. Sources suggest this was the third time Islami Bank Bangladesh Ltd was fined for covering up militants transactions.

GRM was queried and visited client.

**CLIENT'S RESPONSE:**

The client has indicated that the above-referenced case was not of terrorist financing but rather an isolated case of failure/negligence by branch officials to follow their AML guidelines and operating procedures.

**GRM'S COMMENT:**

"We performed the due diligence visit yesterday afternoon." "As we found the explanation on the event and responses to the KYC questionnaire satisfactory, we recommend not to take any further action on Islami Bank. However, considering that Islami Bank is involved in mass banking with a pretty large branch network without a sophisticated or integrated IT platform, there will always be a chance that isolated incidents like this might be found. As such, we will closely monitor the future events and keep you informed as soon as any issue of concern is detected."

Muhammad Shuhuducaman, email dated March 21, 2006  
According to FIG HBUS, various sources have indicated that this is the third time that the client, Islami Bank Bangladesh has been fined for covering up militants' transactions.

Additionally, ROF recommended that the subject client's KYC profile should be classified as SCC due to the following reason:

"one of its shareholders, the Kuwait Finance House, along with several officers from another shareholder, the Islamic Development Bank (Isodo Sanha, Ibrahim Al-Mofleh, and Akka Abdellakout), being categorized as Politically Exposed Persons on World-Check." One of the subject client's shareholder Islamic Development Bank, Jeddah, Saudi Arabia, (7.50%) has membership in 56 countries and field representatives in 11 several countries, some of which are OFAC sanctioned countries.

LCO on 5/15/2007 replied, "As for the IDB connection I would say no to SCC."

LCO was queried for review of status 2/3/2010, replied "The information appearing below does merit SCC classification."

**IV. AML Discussion**

AML Discussion took place 3/29/2011, see visitation section for details

**V. AML Policy**

AML Policy in file.

MTS Questionnaire in file. Client lists 53 MSBs for which it acts as payout agent. Bank of Bangladesh confirms the following as remittance relationships:

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Know Your Customer: Islami Bank Bangladesh Limited

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<p>Client pays out funds but does not transmit, AML program applies and user must have an account. Transactions are monitored as per AML KYC Policy of bank.</p> <p>VI. Notable Information ***** Directors biographies pending</p>	<p>[Redacted]</p>
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## II. Ownership/Management/Business Information

* Name of Principals or Beneficial Owners : (List all shareholders with 10% or more ownership. If Corporate Client not publicly traded, Special Category Client or High Risk Country, then list all shareholders with 5% or more ownership):	* % of ownership:
Arabsas Travel & Tourist Agency K.S.A	9.99
Al Rajhi Company for Industry & Trade, Riyadh Al-KhobarSaudi Arabia	9.84
Islamic Development Bank, JeddahSaudi Arabia	7.50
The Public Institution for Social Security, Kuwait CityKuwait	6.46
Kuwait Finance House KSC, Kuwait CityKuwait	5.25
Abdullah Abdul Aziz Al-Rajhi, KSA	7.58
Others, none with 5% or Greater	43.73
Name of Corporate Officers:	Title: (e.g. Chairman, Vice/Deputy Chairman, President, Chief Executive Officer, Chief Financial Officer, and those Members of the Board or others with direct influence over the operations of the entire organization)
Abu Nasser Muhammad Abdul Zaher	Chairman of the Board
Yousif Abdullah Al-Rajhi	Vice-Chairman
Abdul Mannan	Managing Director
Shamsul Haque	Deputy MD
Mustafa Anwar	Vice chairman
Total Number of Employees:	9588 Source: Bankers almanac
Where is the Client incorporated:	BANGLADESH
Year Established:	1983
What is Client's Rank in country (asset based):	3 Source: Banker's Almanac
How many branches/offices does Client have:	200 Source: Client's website
Where are the branches/offices located:	

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Know Your Customer: Islami Bank Bangladesh Limited

For Foreign Financial Institutions only : Indicate nature of Client's business (select all that apply):	Bangladesh Commercial/Retail Banking, Money Service Business Pay Out Agent, Other: Shariah Banking
Indicate reporting agency or supervisory regulatory body (ies) in the country (ies) of operation:	Bangladesh Bank
* List license type:	* Year of Issuance: 1983 * Country of Issuance: BANGLADESH
Commercial Banking License	
Is Client's Shareholders' Equity 25 Million USD or more?	<input checked="" type="radio"/> Yes <input type="radio"/> No
Has the Client been under the same ownership for last 10 years (or 5 years if in a High Risk Country)?	<input type="radio"/> Yes <input checked="" type="radio"/> No
Is the Client or its Parent State-Owned? (Answer "Yes" if the government has the largest ownership percentage)	<input type="radio"/> Yes <input checked="" type="radio"/> No
Please list principal affiliates which have relationships with HSBC:	None
If the Client or affiliates have other Accounts with HSBC entities provide the country in which each account is located:	HSBC Dhaka

## III. Referral Information

How was the Client introduced to the bank?	Long standing relationship
By whom:	Long standing relationship
Is a GfI form or a CIBM KYC Profile from a referring office in the Client file? (If the client was referred from another HSBC entity office)	<input checked="" type="radio"/> Yes <input type="radio"/> No
Global Relationship Manager (GRM) or Country Relationship Manager (CRM) recommendation received and in Client file?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, name of GRM or CRM:	Sadique Reza
If yes, date:	04/17/2011
Name of Sales/Marketing/Trading person assigned to Client:	Herzel Mehani
Name of Relationship Manager (RM) for KYC Approval:	Wen Lu WU

## IV. Visitation

## General Visitation:

Was a Client Site Visit performed?	<input checked="" type="radio"/> Yes <input type="radio"/> No
------------------------------------	---

## Visitation Details:

Date of visitation:	Most Recent Site Visitation:	Prior Site Visitation:
10/19/2010	01/20/2010	
By Whom:	Shafiqul Hossain, Sadique Reza - Mgr IB/HSB, Raaz S Fakih - Acting CEO Amanah, Amjad Rabul Hasan	Quazi, Ahsan H, RM, IB
Purpose - Banking Products/Services discussed:	Site Visit: Visit Head Office	AML Discussion
Is call report in Client file?	<input checked="" type="radio"/> Yes <input type="radio"/> No	<input checked="" type="radio"/> Yes <input type="radio"/> No
Comments - provide other details regarding visitation (e.g., Client contact name and title, documentation reviewed):	Client Attendees: Atiqur Rahman Khodem - Principal Officer	On site visit with Assistant VP Atiqur Rahman KHADEM

## V. Purpose/Nature of Activity

Transactions*	Expected Frequency	Transactions*	Expected Frequency

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Know Your Customer: Islami Bank Bangladesh Limited

ACH (Clearing House)		Money Market	
ARP (Account Reconciliation)		Securities Lending	
Asset Management		Swaps	
Check Collection (Cash Letter)	Occasionally	Sweep Overnight Investment	Daily
Checks/Demand Drafts		Time Deposits	
Clearing (Funds Transfer)	Daily	Trading - Banknotes *	
Commercial Line		Trading - Bonds	
Commitments		Trading - Derivatives	
Control Disbursement		Trading - Emerging Markets	
Current Account	Daily	Trading - Equities	
Derivatives		Trading - Fixed Income	
Factoring		Trading - Foreign Exchange	
Forward Rate Agreements		Trading - Futures	
Globalization		Trading - Securities (Treasury)	
Guarantees (CD offset, Deposits)		Trading/Lending - Precious/Base Metals	
Intra Day Exposure Limit		Zero Balance Account	
Letters of Credit / Bankers Acceptances	Occasionally		
Loans			
Lockbox		Other:	

\* Refer to Client's file for anticipated volume of activity.

Managing for Value - Client's Profitability for HSBC (Annualized revenue - actual or anticipated, in USD equivalent); This is required for all PCM clients	100,082
--	---------

## VI. Financial Summary

All financial data reported below should be in USD equivalent for comparison purposes globally (e.g., no non-USD currencies and denominated in actual USD dollars).	
Financial Statement date:	12/31/2009
Currency (Local):	BANGLADESH TAKA
Exchange rate (per USD):	68.139100
Denomination:	Actual
Assets:	3,938,140,000
Shareholders Equity:	284,577,000
Net income:	48,174,400

## VII. Documentation Checklist

List of Authorized Signatories and/or Corporate Resolution in Client file?	<input type="radio"/> Yes <input checked="" type="radio"/> No
If no, explain:	Signatures are housed in our Buffalo Office.
Current Annual Report (Form 10-K) or Financial Statement in Client file?	<input checked="" type="radio"/> Yes <input type="radio"/> No
Indicate Banking References and Relationship (List 3) (Name, Country, Date and Relationship):	See below
Is banking reference documentation in Client file (for Clients located in High Risk Countries)?	<input type="radio"/> Yes <input checked="" type="radio"/> No
If no, explain:	Longstanding Relationship: Waived per Compliance's email dd 10/5/04

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Know Your Customer: Islami Bank Bangladesh Limited

Bank Client and Not a Central Bank	
Copy of Banking License in Client file ?	<input checked="" type="radio"/> Yes <input type="radio"/> No

Foreign Bank Client and Not a Central Bank	
Is a USA Patriot Act Certification on file ?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, date received by HSBC:	03/27/2011
If yes, date most recent Certification or Re-Certification was executed/signed by customer? (required by US Treasury every 3 years)	03/27/2011

## VIII. Summary of Reasons

We have reviewed the information provided above in the context of the bank's "Know Your Customer" policy and "due diligence" requirements and criteria. Based on the following summary of reasons, we feel comfortable recommending this client for banking business.

Purpose - Explain the purpose of this account / Client relationship and summarize the anticipated activity :

The purpose of this account is to handle USD funds clearing services; Funds Transfer Clearing Account, Cash Letter, Letters of Credit, Sweep Overnight Investments.

Variance: Clients actual activity for the period 05/01/2009 to 04/30/2010 vs 05/01/2010 to 04/30/2011 showed no variance in actual vs expected volumes.

Ownership - Comment on the owner's / principal's background, history and reputation:

Arabsas Travel & Tourist Agency, 9.999%:

Arabsas Travel & Tourist Agency, Kingdom of Saudi Arabia (K.S.A), 9.99%, is represented by the Al Rajhi Family members. Arabsas is located at Prince Faisal Bin Turki Street, Wizarat District, P.O. Box 152, Riyadh 11411 Saudi Arabia. Tel: (+966-1) 4056555 and Fax: (+966-1) 4066005. Arabsas is a travel agency within the Kingdom of Saudi Arabia.

Source: GRM

Yousif Abdullah Abdul Aziz Al-Rajhi, 9.936%:

Yusif Abdullah Abdul Aziz Al-Rajhi is a businessman within the Kingdom of Saudi Arabia and also the Vice Chairman of the Board of Directors, Islami Bank Bangladesh Limited. Please refer to the Ownership Section below for his details.

Source: GRM

Al-Rajhi Company for Industry & Trade, 9.94%:

According to the ownership confirmation provided by the GRM, Al-Rajhi Company for Industry & Trade is represented by Janah Yusuf Abdullah Abdul Aziz Al-Rajhi (referenced above), Vice Chairman of the Board of Directors, Islami Bank Bangladesh Limited. Please refer to the Ownership Section below for his details. Al-Rajhi Company for Industry & Trade is member of the Al-Rajhi group of companies which specializes in manufacturing building material products and metal fabrication. The Al Rajhi family is considered by most in Saudi Arabia as the country's wealthiest non-royals.

Source: www.alrajhiindustrial.com; & http://en.wikipedia.org/wiki/Al\_Rajhi\_Bank

Abdullah Abdul Aziz Al-Rajhi, 7.58%:

Abdullah Abdul Aziz Al-Rajhi is the Chairman of Gulf Paper Industries Factory (GPIF), a subsidiary of the Al Rajhi group of factories. GPIF is said to be a leading paper mill factory in the Middle East located at the heart of Saudi Arabia.

Source: www.alrajhiigroup.com/english/paper/paper\_main.html

Islamic Development Bank, Jeddah, Saudi Arabia, 7.50%:

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Know Your Customer: Islami Bank Bangladesh Limited

The functions of the Bank are to participate in equity capital and grant loans for productive projects and enterprises besides providing financial assistance to member countries in other forms for economic and social development. The Bank is also required to establish and operate special funds for specific purposes including a fund for assistance to Muslim communities in non-member countries, in addition to setting up trust funds. The Bank is authorized to accept deposits and to mobilize financial resources through Shariah compatible modes. It is also charged with the responsibility of assisting in the promotion of foreign trade especially in capital goods, among member countries; providing technical assistance to member countries; and extending training facilities for personnel engaged in development activities in Muslim countries to conform to the Shariah.

The present membership of the Bank consists of 56 countries. The basic condition for membership is that the prospective member country should be a member of the Organization of the Islamic Conference, pay its contribution to the capital of the Bank and be willing to accept such terms and conditions as may be decided upon by the IDB Board of Governors.

Each member country is represented on the Board by a Governor and an Alternate Governor. Each member has five hundred basic votes plus one vote for every share subscribed. Generally, decisions are taken by the Board of Governors based on a majority of the voting power represented at the meeting. The Board of Governors meets once every year to review the activities of the Bank for the previous year and to decide future policies. In its annual meeting the Board designates a Chairman, who holds office until the election of another Chairman at the next Board meeting. The Board of Governors is the highest policy-making body. It can delegate powers to the Board of Executive Directors for the general operation of the Bank. However, only the Board of Governors can deal with issues relating to membership, increase or decrease in the Bank's authorized capital, authorize cooperation agreements with international and regional organisations, election of the President and Executive Directors and decide their remuneration.

The Bank's principal office is in Jeddah in the Kingdom of Saudi Arabia. Two regional offices were opened in 1984; one in Rabat, Morocco, and the other in Kuala Lumpur, Malaysia. In July 1996, the board of Executive Directors also approved the establishment of an IDB Representative Office at Almaty, Kazakhstan, to serve as a link between IDB member countries and Central Asian Republics. The office became operational in July 1997 and is now a full-fledged Regional Office. The Bank also has field representatives in eleven member countries. These are: Indonesia, Iran, Kazakhstan, Libya, Pakistan, Senegal, Sudan, Gambia, Guinea Bissau, Mauritania and Algeria.

Source: <http://www.isdb.org/irjportal/anonymous?NavigationTarget=navurl//338b0248cc316b93543d314b0123f928>

The Public Institution for Social Security, Kuwait, 6.46%:

Kuwait began a pension scheme on January 1, 1955 within the framework of civil servant system in the public sector. The first independent law for pensions was issued in Law Decree No.3 of 1960. This covered government employees, civil and military, and was followed by an independent law for pensions and indemnities for the military, in accordance with law No.27 of 1961, which came into force on September 8th, 1961.

The Public Institution for Social Security is a public institution of independent budget, having a legal personality and subject to the supervision of the Minister of Finance.

The Institution is managed by a Director General with four deputies. They are liable for the implementation of the policy drawn by the Board of Directors. The Director General specifies the Institution's Departments and the specialization of each.

The works of the Institution are performed through five main sectors, which are General Administration Sector, Insurance Sector, Automation Sector, Investment Sector & Insurance Service Personnel

Source: [http://www.pifss.gov.kw/english/index2\\_eng.htm](http://www.pifss.gov.kw/english/index2_eng.htm)

Kuwait Finance House, 5.25%

Kuwait Finance House (KFH or the Bank) was incorporated in the State of Kuwait in 1977, and is listed on the Kuwait Stock Exchange with a market capitalization of US\$ 1,950 million as of 31 December 2001. KFH has an investment grade rating, and has been rated A3 by Moody's. The Government of Kuwait owns 49% of the equity, and the general public holds the remaining shares. KFH is engaged in providing Islamic banking services, and its spectrum of activities include consumer banking, real estate financing, lease financing, trade finance and portfolio investing, all of which are conducted in strict compliance with Islamic Shariah. The Bank is the market leader in the Islamic banking industry in Kuwait, and holds an estimated 20% of the total deposit base of the country.

During 2002, KFH received a number of regional and international awards, which affirmed the bank's financial strength, quality of assets, and its status as one of the leading banks in the region. In a study carried out by Gulf Banking Consultants based on 2001 financial performance, KFH was ranked first among 25 Gulf based banks in terms of "economic value".

In the global Islamic banking arena, KFH is on the forefront of the industry in terms of profitability and total assets under its management. In terms of total assets and net profits, KFH is ranked second to Al Rajhi Banking and Investment Corporation, Saudi Arabia.

The branch network has grown to 29 branches in Kuwait with separate ladies section. In addition KFH has also recognized the impact of non-branch distribution of services, both in terms of customer service and reduced costs. The bank has become a leader in exploiting technology to serve business needs and its e-Services offer a range of services which we believe to be among the most comprehensive in the world.

Source: <http://www.kfh.com/english/Aboutus/index.asp>

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Others, none with 5% or more shares, 43.34%

**Management - Comment on the Client's professionalism, expertise, experience, and education of senior officers / executives:**

Abu Nasser Muhammad Abdus Zaher - Chairman of the Board (Representative: Ibn Sina Pharmaceutical Industry Limited)  
Born into a devoted Muslim family at Comapanygo in Noakhali on July 1, 1948. He achieved his Masters Degree in English literature from the University of Rajshahi. He is the Managing Director of Ibn Sina Pharmaceuticals Industry Limited. He started his professional life with teaching at Khandaker Mosharraf Hossain Degree College in the seventies. Later, he was assigned at the Royal Embassy of Saudi Arabia to Dhaka as Secretary and performed duties for 13 years. He is the Chairman of Industrialists and Businessmen Association of Bangladesh.

Yousif Abdullah Al-Rajhi - Vice Chairman (Representative: Al-Rajhi Co. for Industry & Trade Industrial Division)

Yousif Abdullah Al-Rajhi obtained his Masters Degree from U.S.A. He is the General Manager of Al-Rajhi Company for Industry & Trade, K.S.A. Earlier, he performed duties of Branch Manager and Project Finance Manager of Al-Rajhi Banking and Investment Corporation during 1987 to 1995.

Source: <http://www.newagebd.com/2007/sep/04/busi.html>

Abdul Mannan, Managing Director

Mohammad Abdul Mannan, Managing Director of Islami Bank Bangladesh Limited joined the bank at the time of its inception in 1983 as Public Relations Officer. Later, he worked in its Nawabpur & Islampur Branch and served as Branch Incumbent in different capacities in Jessore, Mouchak and Head Office Complex Corporate branch for more than a decade with Success. He received the First Best Manager award of the bank for his outstanding performance in 1991 & 1993. He moved to Saudi Arabia in 1995 as the Bank's Marketing & development representative for KSA and subsequently he was simultaneously assigned to five other Gulf States, namely Kuwait, Qatar, Oman, Bahrain and the U.A.E. He served in those GCC countries till June 2000 and did extensive groundwork for facilitating expatriate remittance to the country as well as to the bank. After returning from his assignment abroad he took the charge of Head Office Complex Corporate Branch in August 2000 and under his leadership the branch became one of the top branch of the bank within a very short time. He was promoted to the post of Executive Vice President in January 2003. Mr. Mannan took the charge of International Banking Wing in August 2005. He was promoted as Deputy Executive President in 2006.

Source - <http://www.islamibankbd.com/management.php>

Shamsul Haque, Deputy Managing Director

Md. Shamsul Haque, a career banker joined Islami Bank Bangladesh Limited in 1984 as Principal Officer and served in different capacities in IBBL. He worked as Second Officer of Narayanganj Branch & Rajshahi Branch. He also worked as Manager of Rajshahi Branch, Bogra Branch and also worked as Manager of Foreign Exchange Corporate Branch, Dhaka. He headed Dhaka North Zone and Chittagong Zone to help affiliated branches of respective Zones on progressive line to ensure growth. He also headed Assets Management Division of IBBL and at present he has been entrusted with responsibility for looking after the Internal Control & Compliance Wing of the Bank. He started his career in the Janata Bank as a Probationary Officer in 1979. Later on, he joined the services of United Commercial Bank Limited in 1984 and switched over to Islami Bank Bangladesh Limited in the same year. He obtained his Masters Degree with Honors in Accounting (Finance Group) from Rajshahi University. He obtained Banking Diploma from the Institute of Bankers, Bangladesh. He participated in various training courses, seminars, conferences & workshops at home and abroad and traveled Hongkong, Thailand, Singapore, Malaysia, China, Saudi Arabia, Australia, Iran, UAE and Bahrain. In recognition of his meritorious services, he had been rewarded with Gold Medal for best managerial performance in 1990 and again nominated as one of the Best Managers for the year 1991. He performed the Holy Hajj in the year 2003. Mr. Haque was born in 1st September 1952 in a respectable Muslim family of Noakhata in the neighborhood of Rajshahi Divisional City.

Source - <http://www.islamibankbd.com/management.php>

Mustafa Anwar, Vice Chairman

Source: [http://www.islamibankbd.com/management\\_dts.php?MID=16](http://www.islamibankbd.com/management_dts.php?MID=16)

**Visitation - Summarize information obtained from Client visitations and discussions. (Call Reports, etc):**

AML Discussion - 03/29/2011  
HSBC attendees - Saad Ahmed  
Client Attendees - Aliqu Rahman Khadem

**Detailed Description**

**Existing Attachments**

Since we conducted an FEDD visit to Islami Bank Bangladesh Ltd. along with Mr. Paul M Kennedy, Managing Director, GB FIG and Allen C H Chang, SVP, GB FIG on 01 Mar 11, we completed the customer due diligence over phone. During the meeting, the following issues have been discussed and details are given below:

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**Introduction of New Business and Branch expansion:**

There has been only horizontal expansion of branch network. Total 55 branches including SME branches have been opened since 2008.

**Ownership Changes:**

There has not been any major change in the Banks ownership. ARK confirmed that Mr. Abdullah Abdul Aziz Al-Rajhi is holding more than 5% of the Bank's total shareholding as an individual.

**Change in AML policy:**

Both the Money Laundering Prevention Ordinance, 2008 and Anti-Terrorism Act 2008 have been approved by the Government as Money Laundering Prevention Act and the Anti-Terrorism Act in 2009. However, there has been no change from the ordinances. There has been no change in the AML policy from last questionnaire completion. They have not sent any reporting to the Central Bank regarding AML transaction issue. They have an internal quarterly training on AML, ranging from the officer level to Managers.

**Client on-boarding process:**

Islami Bank Ltd advised that they follow very strict KYC policy prescribed by the central bank. For individual clients, photo ID of the customers like passport, driving license etc. are obtained. In recent days, copy of National Identification Card is preferred. Two copies of customers photographs duly attested by the introducer, who is an existing customer/acceptable person to the Bank is obtained. Same procedures are followed while on-boarding local corporate entities for each of the Directors/Sponsors. In case of cross-border clients, all the related documents must be verified by the Bangladesh Embassy in the country of domicile of the client. For cross-border entities other than individuals, reports are obtained through credit agencies like Dun & Bradstreet and others. In addition to the above, to meet Money laundering Prevention Act requirement, possible transaction profile of the client is also recorded.

**Policy and status regarding Money Business & other high risk customers:**

Dealing with any shell is not permissible in Bangladesh. Islami Bank Bangladesh Ltd does not accommodate any shell bank. According to ARK, they maintain relationships with some exchange houses to facilitate handling of inward remittance business. These exchange houses are maintaining account with them. But the accounts are opened only after the endorsement of Central Bank. Bangladesh Bank, Central Bank considers transacting with money exchange houses as high risk and prescribed specific guidelines to deal with this. It requires the Money Services license issued by the Central Bank or other appropriate authority of its country of domicile. Credit report from any internationally reputed agency, audited financial of last three years, profile of all the directors etc. Also a certificate of clearance from the Bangladesh Consular Office in the country of domicile of the Money Service is required before commencing the relationship with them. ARK confirmed that Islami Bank does not deal with any precious metal or gem traders.

**AML Policy & screening process of restricted clients while on-boarding and transactions:**

Bangladesh is a member of APG, an FATF style body on prevention of money laundering. All APG members commit to effectively implement the FATF's international standards for anti-money laundering and combating the financing of terrorism. Islami Bank advised that as per their AML policy and guidelines, the Branch and Head Office AML Compliance Officers are regularly monitoring the transactions against a list of persons and entities suspected for terrorism which is provided by the Central Bank. Central Bank, Bangladesh Bank in its AML Circular No. 02 dated 17 Jul 2002 specifically identified the requirements of KYC and provided formats for regular reporting of abnormal/suspicious transactions. The Branch Managers of Islami Bank Ltd are Branch Anti Money Laundering Compliance Officer (BAMLCO) who require to submit this report to Chief Anti Money Laundering Compliance Officer (CAMLCO) in the Head Office. CAMLCO decides whether to report the transaction to Central Bank or not. CAMLCO is required to submit a quarterly report to Central Bank on abnormal/suspicious transactions.

**Correspondent banking and payable through accounts:**

Islami Bank Bangladesh Ltd is not allowing any of their customers to provide correspondent banking services through their account maintained with HSBC Bank USA, N.A. Payable through account is also not permissible within the Banking guideline of the country.

**Client Site Visit: 10/19/2010**

HSBC Attendees: Shaifur Hossain, Sadique Reza - Mgr IB/HSS, Razi S Fakih - Acting CEO Amanah, Amhad Rabbul Hasan  
 Client Attendees: Aijur Rahman Khadem - Principal Officer  
 Title: Visit Head Office

The primary purpose of the visit was for Mr. Fakih to ascertain a greater understanding of the Islamic banking market in Bangladesh and to have an insight into the performance of Islami bank in terms of market penetration, market demographics, growth prospective and product assortment.

Mr. Nurul Islam, DMD gave a power point presentation to the HSBC visiting team. The presentation contained an over all financial performance history of the bank. With specific deliberation on an overview of their business growth (average growth 21% over the last decade), asset (USD 3 billion as at 31 Dec 2009) growth (over 20% in last five years), liability (USD 3.5 billion as at 31 Dec 2010) growth (over 20% in the last five years), liquidity position and capital growth, also their wallet share position in the Islamic banking market of Bangladesh was explained in the said presentation along with the Islamic product propositions in offer by them. Mr. Islam also elucidated on the future of the Islamic banking market in Bangladesh and its growth prospective in the coming years. With a market size of 136 million (85% of 160 million) people growth potentials are tremendous for any sort of Islamic banking products in Bangladesh. Mr. Islam mentioned that they were aware of the Shariah council of HSBC and they were very appreciative of the council's composition and the quality.

Mr. Fakih explained to the attendees to the presentation about the Amanah proposition of HSBC and its overall gamete and scope in terms of operations and business objectives. Mr. Fakih also motioned that he was very hopeful about the prospective of the Amanah

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Initiative of HSBC in Bangladesh both in terms of growth and market penetration He advised the Islami bank's representatives that in future if they require any support or clarifications on any issues or product know how (Islamic banking products) they are more than welcome to approach him for assistance and auxiliary dialogue on the queries at hand.

Mr. Sadique Reza advised that IB DAK has already presented the Automated Murabaha Service product of HSBC (overnight swing) to Islami Bank Bangladesh Limited. And the subject product is in discussion and consideration for availing by the said.

Upon the completion of the presentation the HSBC team was directed to meet the managing director (Mr. Md Abdul Mannan) Islami Bank. Mr. Mannan cordially received the visiting team and advised that he was aware and welcomed the HSBC's Islamic banking initiatives in Bangladesh and reiterated the positive prospects of such initiatives. Mr. Fakih thanked Mr. Mannan for his insightful advice and informed that his (Mr. Fakih) visits to the country will increase in the coming days and years as the Amanah preposition develops further to its growth to the pinnacle of the country's Islamic banking market/segment.

Onsite Visitation 1/20/2010

During the meeting Mr. Khadem confirmed that no individual shareholder of the bank is holding over 10% of total shares of the Bank. The latest shareholding position has been requested. Islami Bank confirmed that they do not have any off shore banking activities. They do not entertain any anonymous customer. There was one change in their senior management in last one year.

Mr. Khadem advised that Islami Bank got its own AML policies & guidelines in line with country's Money Laundering Prevention Act, 2009. In the Act, all responsibilities have been entrusted with Bangladesh Bank to investigate and monitor ML cases in the Banks. Islami Bank has got a Compliance Department headed by a senior executive who is responsible for enforcing the AML policies across the Bank, including the Branches. AML training has been included in the induction training for all staff. Workshops, Seminars and trainings on AML are conducted by the Compliance Department in regular intervals. AML training programs with is included in the foundation course for new incumbents.

Onsite Visitation 10/29/2009

Promising branch for large value DCs. Branch is very much willing to get confirmations from HSBC with competitive pricing. They are satisfied with HSBC's service.

Does the Client have KYC and Anti -Money Laundering (AML) policies and procedures documented ?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, has a copy been filed in the Client file ? (Required if Client is in a High Risk Country ):	<input checked="" type="radio"/> Yes <input type="radio"/> No
Does the Client's KYC and AML Policies and Procedures require identification documentation and verification when opening an account?	<input checked="" type="radio"/> Yes <input type="radio"/> No
Does the Client have a screening process regarding the procedures for the establishment of new accounts (including obtaining information on the source of funds )?	<input checked="" type="radio"/> Yes <input type="radio"/> No
Does the Client offer accounts or services to anonymous customers?	<input type="radio"/> Yes <input checked="" type="radio"/> No
Does the Client have an ongoing system in place to monitor and report suspicious activity ?	<input checked="" type="radio"/> Yes <input type="radio"/> No
What are the procedures when unusual transactions are detected as a result of the Client 's ongoing monitoring process ?	When unusual transactions are detected, the transactions are report to the Branch Control Unit and they would report it to the Head Office. If transactions is identified as suspicious, Head Office would report it to the Central Bank.
How are the Client 's KYC and AML Policies and Procedures communicated and enforced in the Client 's network of domestic and foreign offices ?	Client's KYC and AML policies and procedures are communicated and enforced via their Central Control Unit and each Branch Control Unit. The Central Control Unit is responsible for formulating the policies and procedures and monitor each Branch Control Unit.
Does the Client have a formal / Independent Anti-Money Laundering Compliance function ?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, does the Client provide Anti-Money Laundering Training to its employees?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, how often is this AML training provided and to whom ?	Continuous training is provided at least annually to each staff member.
Comment on the Client 's KYC and AML practices (past, present and/or future):	Client has provided a copy of their comprehensive AML guidelines, which covers areas such as identification procedures for new customers, record keeping, recognition and reporting of suspicious transactions, training and awareness etc. A copy of this document is in the client's file.

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Does the Country the Client is located in have KYC and AML laws and regulations ?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, comment on the country's KYC and AML practices (past, present and/or future) regarding prevention of money laundering and terrorist financing.	<p>           Bangladesh is not a regional or offshore financial center. Under the caretaker government that declared a state of emergency when it came to power on January 11, 2007, evidence of funds laundered through the official banking system escalated. The new government instituted a stringent anticorruption campaign that netted more than \$180 million in proceeds—a fraction of the estimated total amount of corrupt funds located both domestically and abroad. Fighting corruption is a keystone of the caretaker government under the state of emergency. Money transfers outside the formal banking and foreign-exchange licensing system are illegal and therefore not regulated. The principal money laundering vulnerability remains the widespread use of the underground hawala or "hundi" system to transfer money and value outside the formal banking network. The vast majority of hundi transactions in Bangladesh are used to repatriate wages from expatriate Bangladeshi workers.         </p> <p>           In April and June 2008 the government promulgated the Money Laundering Prevention Ordinance (MLPO 2008) and the Anti-Terrorism Ordinance (ATO 2008). The laws facilitate international cooperation in recovering money illegally transferred to foreign countries and mutual legal assistance in terms of criminal investigation, trial proceedings, and extradition matters. The GOB has formed a national level committee headed by the Law Adviser and an inter-agency Task Force headed by the Governor of the CB to retrieve illegally transferred money. For the past twenty years, corrupt practices became so common that, between 2001 and 2005, Transparency International ranked Bangladesh in its Corruption Perception Index as the country with the highest level of perceived corruption in the world. In 2008, Bangladesh was ranked 147 out of 180 countries surveyed. Bangladeshis are not allowed to carry cash outside of the country in excess of the equivalent of \$3,000 to South Asian Association for Regional Cooperation (SAARC) countries and the equivalent of \$5,000 to other countries. Proper documents are required by authorized foreign exchange banks and dealers. The GOB does not place a limit on how much currency can be brought into the country, but amounts over \$5,000 must be declared within 30 days. The Customs Bureau is primarily a revenue collection agency, accounting for 40-50 percent of Bangladesh's annual government income.         </p> <p>           Although positive legislation has been passed and progress has been made, the Government of Bangladesh should continue to strengthen its anti-money laundering/terrorist finance regime so that it adheres to world standards. The GOB should support technology enhancements to reporting channels from outlying districts to the Central Bank. While the FIU is growing steadily, the FIU analysts and investigators need to enhance their ability to conduct analysis, investigations, understand money laundering and terror finance methodologies and guide the ROs. Bangladesh law enforcement and customs should examine forms of trade-based money laundering and initiate money laundering and financial crimes investigations at the "street level" instead of waiting for a STR to be filed with the FIU. A crackdown on pervasive customs fraud would add new revenue streams for the GOB. Continued efforts should be made to fight corruption, which is intertwined with money laundering, smuggling, customs fraud, and tax evasion. The GOB should ratify the UN Convention against Transnational Organized Crime.         </p> <p>           Source - <a href="http://www.state.gov/p/ins/ins/nrcrpt/2010/database/141512.htm">http://www.state.gov/p/ins/ins/nrcrpt/2010/database/141512.htm</a> </p>
Sources used for Country KYC, supervisory regime and AML information are set out in the HSBC AML Country Risk List. Please refer to the KYC User Guide.	

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Has the Client been audited?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, date:	03/29/2010
If yes, by whom (Audit Firm):	Aziz Halim Khair Chowdhry (Chartered Accountants) & Howlader Yunus & Co., (Chartered Accountants). Auditor's report was favorable
Does the Client have a credit rating?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, who issued it (S&P, Moody's or other):	Credit Rating Information & Services (CRISL)
If yes, date issued:	06/21/2010
If yes, credit rating:	LT: AA, ST: ST-1

Employing reasonably available information, has due diligence been conducted on the Client's AML record?	<input checked="" type="radio"/> Yes <input type="radio"/> No
Has negative information been identified?	<input type="radio"/> Yes <input checked="" type="radio"/> No

Has Enhanced Due Diligence been conducted for this High Risk Client/Country, which includes Compliance (ICRO) checking OFAC & public databases for the names of the customer, principals/beneficial owners, and executive officers?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, has Compliance confirmed that there is no direct adverse information to preclude business with this client?	<input checked="" type="radio"/> Yes <input type="radio"/> No
If yes, date:	06/29/2009
Date of most recent KYC review:	06/30/2010
Department of the Account Manager / Administrator (AM) who prepared this profile:	Global Payments & Cash Mgmt

## Signature Section

Account Manager / Administrator (AM) Approval:	
Client Services / Manager (CS) Approval:	
Functional Head of Business / Executive (IS) Approval:	
Relationship Manager (RM) Approval:	
Institutional Banking / Team Leader (IB) Approval:	
Regional Money Laundering Control Officer (CO) Approval:	

## APPROVE/DENY HISTORY:

Created: 05/29/2001 10:22:26 AM Converted from Epic

05-23-2001 15:26 PM Created by: &lt;EPIC to KYC Conversion Process&gt;

&lt;Address&gt;:

Head Office  
71, Diksha Commercial Area  
Dhaka - 1000 Bangladesh  
BANGLADESH

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<Approval\_acct\_officer> :  
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 <Legal\_dept> :  
 <Approval\_legal\_dept> :  
 <Legal\_dep\_comments> :

AM Approved: (Old Status In Process), 07/18/2001 12:38 PM: Ravi R Polu  
 No Comments

RM Denied: (Old Status AM Approved), 10/04/2001 05:15 PM: Beth Fisher  
 1. Pls check shareholders. Pls add list of shareholders in Summary section. Refer to list in Almanac.  
 2. Is shareholders' equity more or less than USD25M?  
 Tks.

AM Approved: (Old Status RM Denied), 10/05/2001 12:27 PM: Ravi R Polu  
 OWNERSHIP:

AL RAJHI COMPANY FOR INDUSTRY AND TRADE, RIYADU 14.453%  
 ISLAMIC DEVELOPMENT BANK, JEDDAH 7.55%  
 KUWAIT FINANCE HOUSE KSC, SAFAT 5.286%  
 THE PUBLIC INSTITUTION FOR SOCIAL SECURITY, KUWAIT 8.503%  
 HE ABDYLLAH ABDULLAH AL-RAJHI 7.223%  
 HE MOHAMMAD ABDUL AZIZ 7.223%

REST OF THE SHAREHOLDERS ARE PUBLIC SPONSORS, GENERAL PUBLIC AND GOVERNMENT OF BANGLADESH

Approved: (Old Status AM Approved), 10/11/2001 08:49 AM: Beth Fisher  
 Existing USD account with HBUS.

In Process: (Old Status Approved), 07/31/2003 01:09 PM: Rhonda Lee-Thomas  
 Customer is sent back for re-approval

AM Approved: (Old Status In Process), 07/31/2003 04:45 PM: Rhonda Lee-Thomas  
 Updated all info.

Approved: (Old Status AM Approved), 07/31/2003 04:47 PM: Manwei Huang  
 No Comments

In Process: (Old Status Approved), 12/15/2004 10:07 PM: Rhonda Lee-Thomas  
 Customer is sent back for re-approval

AM Approved: (Old Status In Process), 09/28/2005 11:40 AM: Shannon M Jones  
 KYC profile match supporting doc's on file

CS Approved: (Old Status AM Approved), 09/28/2005 12:05 PM: Sharyn Malone  
 No Comments

IS Denied: (Old Status CS Approved), 09/30/2005 03:01 PM: Bob Shetty  
 Please review and reconcile management / ownership information with details appearing on EDO

AM Approved: (Old Status IS Denied), 06/22/2007 03:26 PM: Angela Cassell-Bush  
 No Comments

CS Denied: (Old Status AM Approved), 06/29/2007 02:39 PM: Gillian E Bachstein  
 Pls update section VIII explaining the purpose of account and also update activity monitoring details. Under general comments,  
 define Islamic Sharia banking.

AM Approved: (Old Status CS Denied), 07/02/2007 11:45 AM: Angela Cassell-Bush  
 ALL CS concerns noted on 06/29/07 have been addressed.

CS Denied: (Old Status AM Approved), 07/11/2007 02:18 PM: Gillian E Bachstein  
 Pls update %age ownership and variance report.

AM Approved: (Old Status CS Denied), 07/11/2007 02:45 PM: Angela Cassell-Bush  
 ALL CS concerns above have been addressed

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CS Approved: (Old Status AM Approved), 07/11/2007 02:44 PM: Gillian E Bachstein  
No Comments

IS Denied: (Old Status CS Approved), 08/30/2007 06:45 PM: Bob Shetty  
Please clarify the ownership position of Al Rajhi

AM Approved: (Old Status IS Denied), 09/06/2007 05:23 AM: Angela Cassell-Bush  
Profile previously IS denied due to no response from the GRM regarding IS Approver request for a comment on the ownership of the Al Rajhi family within this bank. GRM has provided his comment which is documented in Section 1: General Comments Section.

CS Approved: (Old Status AM Approved), 09/10/2007 10:40 AM: Gillian E Bachstein  
No Comments

IS Approved: (Old Status CS Approved), 09/12/2007 05:05 PM: Bob Shetty  
Based on GRM support and clarification re ownership by Al Rajhi Organization.

IB Denied: (Old Status IS Approved), 10/10/2007 02:04 PM: Lawrence Korp  
Subject bank not known to CIB.

CS Approved: (Old Status AM Approved), 12/06/2007 11:26 AM: Gillian E Bachstein  
No Comments

IS Approved: (Old Status CS Approved), 12/11/2007 03:43 PM: Bob Shetty  
See my earlier comments

IB Approved: (Old Status IS Approved), 12/12/2007 09:02 AM: Christopher Lok  
No Comments

Approved: (Old Status IB Approved), 03/10/2008 05:40 PM: Alan P Williamson  
Please provide explanation of activity variance in this account within 30 days. Also please note that visitation is due within a month.

In Process: (Old Status Approved), 03/02/2010 05:04 PM: Jon K Jones

Name of principals changed from: [Arabias Travel & Tourist Agency, Janab Yousif Abdullah Al-Rajhi, Al-Rajhi Co. for Industry & Trade, Abdullah Abdul Aziz Al-Rajhi, Islamic Development Bank, The Public Institution for Social Security, Kuwait Finance House, Others, none with 5% or more shares] to: [Arabias Travel & Tourist Agency, Janab Yousif Abdullah Al-Rajhi, Al-Rajhi Co. for Industry & Trade, Abdullah Abdul Aziz Al-Rajhi, Islamic Development Bank, The Public Institution for Social Security, Kuwait Finance House, Others, none with 5% or Greater]  
BankNotes Activity changed from: [See Banknotes Activity Section] to: []

AM Approved: (Old Status In Process), 03/02/2010 05:05 PM: Jon K Jones  
No Comments

CS Approved: (Old Status AM Approved), 03/31/2010 11:45 PM: Gillian E Bachstein  
No Comments

IS Approved: (Old Status CS Approved), 05/07/2010 08:29 PM: Bob Shetty  
No Comments

IB Approved: (Old Status IS Approved), 06/29/2010 11:48 AM: Wen Lu WU  
No Comments

Approved: (Old Status IB Approved), 06/30/2010 11:39 AM: Joanna S Flanagan  
No Comments

In Process: (Old Status Approved), 06/03/2011 02:14 AM: Arjeet NEOGI

Name of principals changed from: [Arabias Travel & Tourist Agency, Janab Yousif Abdullah Al-Rajhi, Al-Rajhi Co. for Industry & Trade, Abdullah Abdul Aziz Al-Rajhi, Islamic Development Bank, The Public Institution for Social Security, Kuwait Finance House, Others, none with 5% or Greater] to: [Arabias Travel & Tourist Agency K.S.A, Al Rajhi Company for Industry & Trade, Riyadh Al-Khobar Saudi Arabia, Islamic Development Bank, Jeddah Saudi Arabia, The Public Institution for Social Security, Kuwait City, Kuwait, Kuwait Finance House KSC, Kuwait City, Kuwait, Abdullah Abdul Aziz Al-Rajhi, KSA, Others, none with 5% or Greater]  
Ownership percentage changed from: [9.99, 9.94, 9.94, 7.58, 7.5, 6.46, 5.25, 43.34] to: [9.99, 9.94, 7.5, 6.46, 5.25, 7.58, 43.73]

#### Revision History

Editor	Date	Reason for Update
--------	------	-------------------

03/09/2012 04:37:44 PM

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Confidential Treatment Requested

HSBC-PSI-PROD-0117236

Know Your Customer: Islami Bank Bangladesh Limited

Arjeet NEOGI	06/03/2011 02:14:58 AM	Annual Review, General Comments
Frashiah X Muiruri	04/06/2011 10:28:57 AM	Update to US Pat Cert date
Frashiah X Muiruri	02/09/2011 10:03:00 AM	For BAU Purposes
Karyn X Scarfo	02/02/2011 09:03:44 AM	Updated visitation
Danielle X Fawra	08/18/2010 02:19:19 PM	updated new RM—prev memo incorrect
Danielle X Fawra	08/17/2010 03:57:22 PM	prev memo error—should be updated new RM
Danielle X Fawra	08/17/2010 03:36:33 PM	update for potential exit of this relationship
Shannon M Jones	08/10/2010 03:29:32 PM	Updated certification date
Shannon M Jones	07/28/2010 01:24:55 PM	updated certification date
Jon K Jones	06/30/2010 04:22:35 PM	Update Review Date for Fully approved

## CRR Revision History

Last Updated By On	Update Type(Field/General)	Old Value	New Value
Arjeet NEOGI - 6/3/2011 2:15:08 AM	rpt_epic_address2	Dhaka - 1000 Bangladesh	Dhaka, Bangladesh 1000
	epic_city	Dhaka	In Process
	Status	Approved	Abdul Mannan
	rpt_epic_nameOfCorpOfficers3	M. Fariduddin Ahmad	Shamsul Haque
	rpt_epic_nameOfCorpOfficers4		Mustafa Anwar
	rpt_epic_nameOfCorpOfficers5		Arabass Travel & Tourist Agency
	rpt_epic_nameOfPrincipals1	Arabass Travel & Tourist Agency	Al Rajhi Company for Industry & T
	rpt_epic_nameOfPrincipals2	Janab Yousff Abdullah Al-Rajhi	Al-KhobarSaudi Arabia
	rpt_epic_nameOfPrincipals3	Al-Rajhi Co. for Industry & Trade	Islamic Development Bank, Jedd
	rpt_epic_nameOfPrincipals4	Abdullah Abdul Aziz Al-Rajhi	Arabia
	rpt_epic_nameOfPrincipals5	Islamic Development Bank	The Public Institution for Social S
	rpt_epic_nameOfPrincipals6	The Public Institution for Social Security	Kuwait CityKuwait
	rpt_epic_nameOfPrincipals7	Kuwait Finance House	Kuwait Finance House KSC, Kuw
	rpt_epic_nameOfPrincipals8	Others, none with 5% or Greater	CityKuwait
			Abdullah Abdul Aziz Al-Rajhi, KS
			Others, none with 5% or Greater

03/09/2012 04:37:44 PM

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Confidential Treatment Requested

HSBC-PSI-PROD-0117237

**From:** Bean, Elise (HSGAC)  
**To:** Robertson, Mary (HSGAC)  
**Cc:** Schram, Zachary (HSGAC); Stuber, Laura (HSGAC)  
**Subject:** FW: Senate Inquiry  
**Date:** Thursday, July 05, 2012 5:04:05 PM  
**Attachments:** AML Policy of IBBL.pdf

---

**From:** Md. Nurul Islam [mailto:mnislam@islamibankbd.com]  
**Sent:** Wednesday, July 04, 2012 08:52 AM  
**To:** Schram, Zachary (HSGAC)  
**Subject:** Senate Inquiry

Dear Sir,

Greetings!

Please find below the responses of your queries:

**1. What is Islami Bank's relationship with HSBC, including HSBC Bank USA (HBUS)?**

Islami Bank Bangladesh Limited (IBBL) is the largest private sector commercial bank in Bangladesh which has got around 600 hundred correspondent banking network including almost all globally reputed banks in different locations. HSBC is one of such correspondent banks of Islami Bank Bangladesh Limited. In this process, Relationship between Islami Bank Bangladesh Ltd. and HSBC began in early 2000 by arranging RMA (Relationship Management Application) with different HSBC Group offices. Later, an USD account in HSBC Bank USA N.A. was opened on 11 October 2000. The USD ACU (Asian Clearing Union) accounts with HSBC India and Pakistan were opened on 28 April 2006 and 23 July 2006 respectively. So far, we have got RMA arrangement with HSBC in 24 locations of the world which includes Australia, Brazil, Canada, China, Dhaka, Hong Kong, India, Indonesia, Italy, Japan, South Korea, Malaysia, Mexico, Pakistan, Peru, Singapore, Spain, Switzerland, Taiwan, Thailand, Turkey, UAE, UK and USA. The purpose of this relationship is to facilitate our foreign trade related transactions i.e. LC advising, trade confirmation, trade

Permanent Subcommittee on Investigations  
**EXHIBIT #87a**

PSI-IBBL-01-0001

payments, trade receipts, customer receipts and treasury coverage.

**2. What is Islami Bank's relationship with the Al Rajhi group and the Al Rajhi family?**

At the outset, Central Bank took initiatives for establishment of Islamic Banking in Bangladesh. Islami Bank Bangladesh Limited was incorporated in 1983 with the initiatives of Government of Bangladesh including renowned local and foreign sponsors. Among the foreign sponsors, Islamic Development Bank, Kuwait Finance House, Kuwait, Dubai Islami Bank, UAE, Bahrain Islami Bank, Bahrain, Ministry of Awqaf and Islamic Affairs, Kuwait (Present Name: Kuwait Awqaf Public Foundation, Kuwait), The Public Institution for Social Security, Kuwait, Al-Rajhi Company for Currency Exchange and Commerce KSA (Present Name: Al-Rajhi Company for Industry and Trade, KSA) and Ministry of Justice, Department of Minors Affairs Kuwait (Present Name: The Public Authority for Minors Affairs, Kuwait), Jordan Islamic Bank, Islamic Banking System International Holdings S.A., Luxembourg were prominent. Government of Bangladesh joined with 5 percent shares and continued until government decided to offload its shares from all private commercial banks. These entities along with Al-Rajhi Company for Industry and Trade, KSA have been elected Director of our bank from time to time. At present Mr. Abdullah Abdul Aziz Al-Rajhi from Al-Rajhi family is also a shareholder and director of the Bank.

**3. What are Islami Bank's KYC and AML practices?**

We have adopted our AML policy in line with Central Bank regulation and relevant acts of the government and follow the same strictly and meticulously. For details, please find attached our AML Policy.

**4. Did Abdur Rahman, chief of the Jamaatul Mujahidden of Bangladesh have any accounts at Islami Bank? Please describe those accounts, including relevant dates.**

We have had no account in the name of either Abdur Rahman or the organization under question.

**5. What were the findings of any Central Bank of Bangladesh investigation into Islami Bank since 2005?**

Central Bank as a regulator of this Banking Industry conducts their regular and routine inspection & investigations from time to time since establishment of the Bank in 1983. Till today we do not have any mentionable outstanding issue with the Central Bank regarding the aforesaid investigations other than routine matters. However, an incident took place in 2006 in connection with some transactions originated from our Gazipur and Savar Branches through eight telegraphic transfers for an amount ranging from BDT 10,000(USD 144) to BDT 79,000 (USD1,137) of

PSI-HBL-01-0002

1000

altogether sum BDT 4,17,000 equivalent to approximately USD 6,000(United States Dollar six thousand). The transfers were destined to an account in the name of one Mr. Saidur Rahman who had opened account with our Laldighirpar Branch, Sylhet in February 1999 complying all usual norms. Initially, the concerned officials did not find anything suspicious in good faith. Upon inspection from Head Office, it was revealed that the transactions were made in an inoperative account and thereby suspicious in nature and then we made STR to Central Bank. Instantly, Bank also suspended the concerned officials. As the reporting was not done in time, Central Bank fined BDT one hundred thousand (equivalent to USD 1,439) and IBBL paid the amount. Later on, IBBL carried a thorough investigation on the matter and terminated the delinquent officials from the service of the bank. Mentionable that several banks including some foreign bank were also fined by Central Bank at that time due to failure of timely STR.

**6. Did the International Islamic Relief Organization have any accounts at Islami Bank?  
Please describe those accounts, including relevant dates.**

International Islamic Relief Organization (IIRO) had accounts bearing number [REDACTED] and [REDACTED] with our bank. These accounts were opened on 17.04.1993 and 06.06.1994 respectively as a regular and approved NGO and maintained with our bank till 03.08.2010 along with other 2(two) Banks. As the entity was a UN sanction listed organization informed by Central Bank in 2006, we instantly froze the accounts and confirmed our actions to the Central Bank and there was no transaction from that date to 03.08.2010 i.e till transfer. In 2010, we received instruction from Central Bank at the direction of Ministry of Finance, Government of Bangladesh to defreeze the accounts in the name of IIRO maintained with three banks including IBBL and transfer the accounts with IBBL to BASIC Bank, a Government owned bank and accordingly we confirmed our actions to Central Bank.

We feel our reply will satisfy your query and please feel free to contact us if you have got any query further.

Thanking You,

Md. Nurul Islam  
Deputy Managing Director &  
Head of International Banking Wing  
Islami Bank Bangladesh Limited

— = Redacted by the Permanent  
Subcommittee on Investigations

PSI-IBBL-01-0003



----- Original Message -----

**From:** AMM FARHAD/Social Islami Bank Limited.  
**To:** Schram, Zachary (HSGAC)  
**Cc:** 'Golam Kibria, SIBL ID' ; mds@sibl-bd.com ; 'MR. MUHAMMAD ALI' ; 'MR. QUAZI FAZLUL KARIM'  
**Sent:** Tuesday, July 10, 2012 7:57 PM  
**Subject:** Re: Senate Inquiry

Dated: July 10, 2012

**Mr. Zachary Schram**  
 Senior Counsel  
 Permanent Subcommittee on Investigations  
 United States Senate  
 202-224-9379.

Dear Sir,

This has reference to your email dated June 30, 2012 and our subsequent reply dated July 5, 2012 on your questionnaire, pursuant to your investigations on HSBC.

In this regard, we furnish below our response to all your queries chronologically.

1. What is Social Islami Bank's relationship with HSBC, including HSBC Bank USA (HBUS)?  
How has the relationship changed over time?

Ans: Social Islami Bank Ltd. had account relationship with HSBC Bank USA for the purpose of reimbursement of import Payments against letters of credit opened by our different branches; receive export proceeds and also inwards remittance.  
 Effective from May 2012 we DO NOT have any kind of relationship with HSBC, including HSBC Bank USA.

2. What are Social Islami Bank's KYC and AML practices?

Ans: Social Islami Bank Ltd. has its own AML Policy and separate AML Compliance Cell for fighting money laundering, terrorist financing and ensuring "know your customer" KYC.

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**EXHIBIT #87b**

PSI-SIBL-01-0001

The Bank's Management strictly ensures the compliance with all statutory and regulatory requirements, including designating AML Officer for this specific purpose and conducting training for staff at all levels.

Bank's compliance with Anti-Money-Laundering requirements and procedures is monitored by the Central Bank of Bangladesh (Bangladesh Bank) and also by Bank's internal and external auditors.

Each and every account of the bank and any transaction in any account are fully complied with our KYC procedures.

**3. Please describe the relationship of Social Islami Bank with the Al Rajhi group?**

Ans: Social Islami Bank **DOES NOT** have any kind of relationship with Al Rajhi group.

**4. Was Abdul Majid of Singapore a director of Social Islami bank? Was the same Abdul Majid arrested by the Singapore government for terrorism-related activities? What was the result of any legal action against Mr. Majid?**

Ans: SIBL Board had never a Director named Mr. Abdul Majid and as such the answer is that Mr. Abdul Majid of Singapore **WAS NEVER** a director of Social Islami bank.

**5. Please describe the relationship of Social Islami Bank with the International Islamic Relief Organization (IIRO)? Is (or was) the IIRO a shareholder of Social Islami Bank?**

Ans: International Islamic Relief Organization (IIRO) is a foreign shareholder of Social Islami Bank who currently holds 1.61% share of the bank. It is of mention that the bank doesn't have any transactions with this organization except that this organization purchased some primary shares of the bank when it was floated in 1995, during the year of bank's inception. In 2006 we came to know that the United Nations Security Council enlisted International Islamic Relief Organization (IIRO) under "Individuals and Entities Associated with Al Qaida" as one of the Directors of IIRO was accused of having association with Al Qaida.

The matter was viewed with due concern by the management and the Board of the bank. The management of the bank placed the issue before the Shareholders of the bank in the 11th Annual General Meeting (AGM) held on 06.11.2006 and adopted a resolution unanimously that the whole shares held by International Islamic Relief Organization will be disposed off by way of sale/transfer in accordance with the law of Securities and Exchange Commission (SEC), Bangladesh Bank and in line with the law of the land.

The matter was also taken to the notice of Bangladesh Bank and Securities Exchange Commission. The Central Bank issued instruction on 10.12.2006 not to disburse any bonus shares, issue of right shares or pay any cash dividend to IIRO until further instructions of Bangladesh Bank.

PSI-SIBL-01-0002

In compliance with the instructions of Bangladesh Bank, the bank immediately stopped issuing bonus shares, right shares and paying any cash dividend to IIRO.

To overcome the situation the bank communicated with IIRO several times and requested them to dispose off their entire share held with the bank by way of sale/transfer but they did not respond to the bank's request to offload their shares.

A Board Memo was then placed before the Board of Directors of the bank on 30.06.2009 and the Board unanimously agreed to dispose off the whole shares held by International Islamic Relief Organization (IIRO). The Board of Directors also agreed to seek permission from the High Court praying for Court's intervention to sell the entire shareholding of IIRO in the capital market and the proceeds may be deposited in any government account/screw account or as would be determined by the Hon'ble court of justice to save the Bank from any unwanted trouble and for smooth operation of the foreign exchange business of the Bank.

But in 2010 Ministry of Finance, Government of the Peoples Republic of Bangladesh has issued a circular dated 31/05/2010 providing IIRO permission to run their business/ activities legally in Bangladesh.

The Central Bank has also endorsed the circular issued by the Ministry of Finance, Government of the Peoples Republic of Bangladesh vide their Letter No. AMLD-432010-2797 dated 30.06.2010 and instructed us to comply with the Circular issued by the Ministry of Finance.

Under the above circumstance, the bank is under definite obligation in paying dividend/ issuing bonus shares/ right shares to IIRO as per the instructions of the Central Bank and Ministry of Finance which were not paid/ issued in their favour till 31/05/2010.

**06. Does (or did) IIRO have any accounts at Social Islami Bank? Please describe those accounts, including relevant dates.**

Ans: IIRO has only one Foreign Currency Account with the bank which they opened in 1995 at the time of buying primary shares of the bank. Present balance of the account is zero. Other than that the bank does not have any sort of transaction in that account of IIRO.

**07. Please describe the relationship of Social Islami Bank with the Islamic Charitable Society Lajnat al-Birr Al Islam (Lajnat al-Birr)? Is (or was) the Lajnat al-Birr a shareholder of Social Islami Bank?**

Ans: The Islamic Charitable Society Lajnat al-Birr Al Islam (Lajnat al-Birr) is a foreign shareholder of Social Islami Bank who currently holds 0.22% share of the bank. It is of mention that the bank doesn't have any transactions with this organization except that this organization purchased some primary shares of the bank when it was floated in 1995, during the year of bank's inception.

PSI-SIBL-01-0003

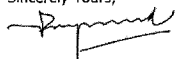
08. Does (or did) Lajnat al-Birr have any accounts at Social Islami Bank? Please describe those accounts, including relevant dates.

Ans: Lajnat al-Birr DOES NOT have any account with the bank.

Should you have any query or require further clarification please feel free to contact us.

With thanks & Kinds regards,

Sincerely Yours,



A.M.M. Farhad

Deputy Managing Director,

Social Islami Bank Ltd,

Head Office,

City Center, Level (18-21)  
103, Motijheel C/A, Dhaka, Bangladesh.  
Tel: + 88 09612001122 / 50006  
Fax: + 88 02 9564944  
E mail: ammfarhad@sibl-bd.com: [REDACTED]

Web: [www.siblbld.com](http://www.siblbld.com)  
Skype: farhadamm

— = Redacted by the Permanent  
Subcommittee on Investigations

PSI-SIBL-01-0004

1005

Occ-Psi-00409214

From: ANNE LIDDY/HBUS/HSBC  
Sent: 9/9/2008 7:25:51 AM  
To: DENISE A REILLY/HBUS/HSBC@HSBC02  
CC:  
Subject: Fw: Hokuriku Bank Ltd- Compliance query

Denise, do you know when Denis was planning on providing the overall summary document on this overall topic? I am anxious to review, including together with the below info, to determine if we need to file any further reports. Thanks.

Anne Liddy  
SVP, AML Compliance | HSBC Bank USA, N.A.  
452 5th Avenue, Tower 7, New York, NY 10018

Phone 212-525-5906  
Fax 212 525 5769  
Email anne.liddy@us.hsbc.com

----- Forwarded by Anne Liddy/HBUS/HSBC on 09/09/2008 08:20 AM -----

Judy P Stoldt/HBUS/HSBC@HSBC02  
09/09/2008 07:25 AM

To  
Anne Liddy/HBUS/HSBC@HSBC, Denise A Reilly/HBUS/HSBC@HSBC, Mary A Caskin/HBUS/HSBC@HSBC  
cc  
Jonathan Dean/HBUS/HSBC@HSBC  
Subject  
Fw: Hokuriku Bank Ltd- Compliance query

Information from Hokuriku Bank regarding some of the car dealerships they do business with that we questioned. Its very limited information that took us over a month to get.

Judy P Stoldt  
Vice President, AML Compliance | HSBC Bank USA, National Association  
One HSBC Center  
Buffalo, New York 14203

Phone (716) 841- 6425  
Fax (212) 382 - 7586  
Email judy.p.stoldt@us.hsbc.com

----- Forwarded by Judy P Stoldt/HBUS/HSBC on 09/09/2008 07:17 AM -----

Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC  
09/09/2008 03:52 AM

To  
Judy P Stoldt/HBUS/HSBC@HSBC02  
cc  
Anthony Julian/HBUS/HSBC@HSBC02, Garie S K HO/PCM ASP/HBAP/HSBC@HSBC,  
Jennifer  
E Kelleher/HBUS/HSBC@HSBC02, Jennifer FONG/TKY/HBAP/HSBC@HSBC, Stephanie L

Permanent Subcommittee on Investigations

EXHIBIT #88

1006

Occ-Psi-00409214  
Napier/HBUS/HSBC@HSBC02, Saeka TAKEBAYASHI/TKY/HBAP/HSBC@HSBC  
Subject  
Re: Fw: Hokuriku Bank Ltd- Compliance query

Judy,

Thank you for waiting. Please find attached the original copy prepared by  
Hokuriku Bank and the one translated by myself.

Hope it helps.

Regarding the other batch, I shall forward the information as soon as details  
are received.

Best regards,

Ako Kobayashi  
PCM Client Services  
HSBC, Tokyo

Judy P Stoldt/HBUS/HSBC@HSBC02  
08 Sep 2008 21:35 Mail Size: 49719

To  
Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC  
CC  
Subject  
Re: Fw: Hokuriku Bank Ltd- Compliance query

Our Ref  
Your Ref

Ako,

Thank you for your assistance in getting us the information.

Regards,

Judy P Stoldt  
Vice President, AML Compliance | HSBC Bank USA, National Association  
One HSBC Center  
Buffalo, New York 14203

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Page 2

1007

OCC-Psi-00409214

Phone (716) 841- 6425  
Fax (212) 382 - 7586  
Email judy.p.stoldt@us.hsbc.com

---

Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC  
09/08/2008 05:58 AM

To  
Judy P Stoldt/HBUS/HSBC@HSBC02  
cc  
Anthony Julian/HBUS/HSBC@HSBC02, Garie S K HO/PCM ASP/HBAP/HSBC@HSBC,  
Jennifer  
E Kelleher/HBUS/HSBC@HSBC02, Jennifer FONG/TKY/HBAP/HSBC@HSBC, Stephanie L  
Napier/HBUS/HSBC@HSBC02  
Subject  
Fw: Hokuriku Bank Ltd- Compliance query

Judy,

I have called Hokuriku Bank and received the required information. However as  
the information is provided in Japanese, I shall forward it as soon as  
translation is ready. It won't take long.

Appreciate your understanding.

Best regards,

Ako Kobayashi  
PCM Client Services  
HSBC, Tokyo

----- Forwarded by Ako KOBAYASHI/TKY/HBAP/HSBC on 2008/09/08 18:54 -----

Ako KOBAYASHI/TKY/HBAP/HSBC  
06 Sep 2008 12:14 Mail Size: 42762  
Phone No. 813 5203 3161

To  
Stephanie L Napier/HBUS/HSBC@HSBC02  
cc  
Anthony Julian/HBUS/HSBC@HSBC02, Garie S K HO/PCM ASP/HBAP/HSBC@HSBC,  
Jennifer  
E Kelleher/HBUS/HSBC@HSBC02, Jennifer FONG/TKY/HBAP/HSBC@HSBC, Judy P  
Stoldt/HBUS/HSBC@HSBC02  
Subject  
Re: Fw: Hokuriku Bank Ltd- Compliance query

Our Ref

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Your Ref

Stephanie,

Noted. I shall call Hokuriku Bank again first thing Monday morning and give Judy the update.

Best regards,

Ako Kobayashi  
PCM Client Services  
HSBC, Tokyo

Stephanie L Napier/HBUS/HSBC@HSBC02  
06 Sep 2008 00:12 Mail Size: 36347

To  
Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC  
CC  
Garie S K HO/PCM ASP/HBAP/HSBC@HSBC, Jennifer FONG/TKY/HBAP/HSBC@HSBC, Judy  
P  
Sto]dt/HBUS/HSBC@HSBC02, Anthony Julian/HBUS/HSBC@HSBC02, Jennifer E  
Kelleher/HBUS/HSBC@HSBC02  
Subject  
Re: Fw: Hokuriku Bank Ltd- Compliance query

Our Ref

Your Ref

Ako, this has been a long outstanding request. It is imperative that Compliance receive the response to our inquiry. Please urgently follow-up with client.

Best regards,

Stephanie L Napier  
AVP AML Compliance | HSBC Bank USA  
90 Christiana Road, New Castle, DE 19720

---

Phone. 302 327 2161  
Fax. 302-3272250  
Email. stephanie.l.napier@us.hsbc.com

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Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC

Page 4



1009

09/03/2008 04:33 AM

Occ-Psi-00409214

To  
Stephanie L Napier/HBUS/HSBC@HSBC02  
CC  
Jennifer FONG/TKY/HBAP/HSBC@HSBC, Garie S K HO/PCM ASP/HBAP/HSBC@HSBC  
Subject  
Re: Fw: Hokuriku Bank Ltd- Compliance query

Stephanie,

Regarding the information requested, I have contacted Hokuriku Bank and was advised that the report has already been prepared. I shall forward it to you as soon as the copy has been received.

Best regards,

Ako Kobayashi  
PCM Client Services  
HSBC, Tokyo

Stephanie L Napier/HBUS/HSBC@HSBC02  
02 Sep 2008 23:28 Mail Size: 28276

To  
Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC  
CC  
Subject  
Fw: Hokuriku Bank Ltd- Compliance query

Our Ref

Your Ref

Ako, I understand you have replaced Yumi. Please follow-up on the promised information.

Best regards,

Stephanie L Napier  
AVP AML Compliance | HSBC Bank USA  
90 Christiana Road, New Castle, DE 19720

Phone. 302 327 2161  
Fax. 302-3272250  
Email. stephanie.l.napier@us.hsbc.com  
Page 5

1010

Occ-Psi-00409214

----- Forwarded by Stephanie L Napier/HBUS/HSBC on 09/02/2008 10:26 AM -----

Kyoko OKAZAKI/TKY/HBAP/HSBC@HSBC  
08/07/2008 10:54 PM

To  
Stephanie L Napier/HBUS/HSBC@HSBC02  
CC  
Judy P Stoldt/HBUS/HSBC@HSBC02, Nanayo Ryan/HBUS/HSBC@HSBC02, Yumi  
SETO/TKY/HBAP/HSBC@HSBC  
Subject  
Re: Hokuriku Bank Ltd- Compliance query

Dear Stephanie,

They are still preparing the report and will provide us within 4th week of  
AUG08.

Kind regards,  
Kyoko Okazaki  
PCM Client Services  
HSBC Tokyo

Stephanie L Napier/HBUS/HSBC@HSBC02  
06 Aug 2008 00:27 Mail Size: 21975

To  
Yumi SETO/TKY/HBAP/HSBC@HSBC  
CC  
Judy P Stoldt/HBUS/HSBC@HSBC02, Kyoko OKAZAKI/TKY/HBAP/HSBC@HSBC, Nanayo  
Ryan/HBUS/HSBC@HSBC02  
Subject  
Re: Hokuriku Bank Ltd- Compliance query

Our Ref

Your Ref

Yumi, please advise status of information required.

Thanks

Best regards,

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1011

Stephanie L Napier  
AVP AML Compliance | HSBC Bank USA  
90 Christiana Road, New Castle, DE 19720

Occ-Psi-00409214

Phone. 302 327 2161  
Fax. 302-3272250  
Email. stephanie.l.napier@us.hsbc.com

Yumi SETO/TKY/HBAP/HSBC@HSBC  
07/28/2008 04:43 AM

To  
Stephanie L Napier/HBUS/HSBC@HSBC02  
CC  
Judy P Stoldt/HBUS/HSBC@HSBC02, Kyoko OKAZAKI/TKY/HBAP/HSBC@HSBC, Nanayo  
Ryan/HBUS/HSBC@HSBC02  
Subject  
Re: Hokuriku Bank Ltd- Compliance query

Stephanie

They are preparing the report.

Yumi Seto  
PCM Client Service  
HSBC Tokyo

Stephanie L Napier/HBUS/HSBC@HSBC02  
26 Jul 2008 04:23 Mail Size: 14298

To  
Yumi SETO/TKY/HBAP/HSBC@HSBC  
CC  
Judy P Stoldt/HBUS/HSBC@HSBC02, Kyoko OKAZAKI/TKY/HBAP/HSBC@HSBC, Nanayo  
Ryan/HBUS/HSBC@HSBC02  
Subject  
Re: Hokuriku Bank Ltd- Compliance query

Our Ref

Your Ref

Yumi, just a quick follow-up. Any update?  
Page 7

1012

Occ-Psi-00409214

Best regards,

Stephanie L Napier  
AVP AML Compliance | HSBC Bank USA  
90 Christiana Road, New Castle, DE 19720

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Phone. 302 327 2161  
Fax. 302-3272250  
Email. stephanie.l.napier@us.hsbc.com

---

Yumi SETO/TKY/HBAP/HSBC@HSBC  
07/15/2008 02:46 AM

To  
Stephanie L Napier/HBUS/HSBC@HSBC02  
Cc  
Judy P Stoldt/HBUS/HSBC@HSBC02, Kyoko OKAZAKI/TKY/HBAP/HSBC@HSBC, Nanayo  
Ryan/HBUS/HSBC@HSBC02  
Subject  
Re: Hokuriku Bank Ltd- Compliance query.

Stephanie

We have today contacted Hokuriku Bank Ltd.  
On receipt of their reply, we will advise you.

Thanks and regards,  
Yumi Seto  
PCM Client Service  
HSBC Tokyo

Stephanie L Napier/HBUS/HSBC@HSBC02  
15 Jul 2008 01:13 Mail Size: 173608

To  
Yumi SETO/TKY/HBAP/HSBC@HSBC  
Cc  
Kyoko OKAZAKI/TKY/HBAP/HSBC@HSBC, Nanayo Ryan/HBUS/HSBC@HSBC02, Judy P  
Stoldt/HBUS/HSBC@HSBC02  
Subject  
Hokuriku Bank Ltd- Compliance query

Our Ref

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Your Ref

Occ-Psi-00409214

Redacted by the Permanent  
Subcommittee on Investigations

Yumi, hope all is well. As you know I moved on to Compliance. I am tasked with Target Monitoring. We have undertaken a review of Hokuriku Bank acct [REDACTED]. We've noticed a pattern of payments which we seek information for the Beneficiary & Originator (if known). Our inquiry is based on either insufficient details within the payment or lack of internet information to adequately research BEN or ORG.

We'd appreciate your reaching out to the client to obtain requested information. Thank you in advance.

Parties in question:

Name	#Trans	Period	\$total
De Araujo Roseli Aparecida	6	4/08-5/08	\$24,480
Aksys Corporation, Japan	3	all 5/7/08	\$60,000
R S Corporation	3	5/08	\$54,000
Sanhu Corporation Imizi-Shi Shitim	15	4/08-6/08	\$810,800

I have attached a sample payment for each.

[attachment "r1495569.tif" deleted by Stephanie L Napier/HBUS/HSBC]

Below Information being sought

Individual Address & DOB or Customer Location( whichever is applicable):  
Place of incorporation ( if applicable):  
Nature of business:  
Beneficial owners (if applicable):  
How long a client:  
Reason for the transfer(s):  
Does the bank's due diligence on this customer and transaction(s) appear satisfactory.  
Relationship between the originator / beneficiary if known

Best regards,

Stephanie L Napier  
AVP AML Compliance | HSBC Bank USA  
90 Christiana Road, New Castle, DE 19720

Phone. 302 327 2161  
Fax. 302-3272250  
Email. stephanie.l.napier@us.hsbc.com

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Occ-Psi-00409214

Attachment: image.tif.zip  
Attachment: information.xls.zip

Page 10

1015

2008-09-09 15:49 FROM HSBC TOKYO CASH MGMT

TO Kobayashi

P.01/01

香港上海銀行 小林 様

OCC-PSI-00409215

9/6  
北陸弘宝田

	(シンミナト)	(ホリオカ)	(ノスキ)	(ホリオカ)
	DE ARANJO ROSELI APARECIDA	AKSYS CORPORATION	RS CORPORATION	SANDHU CORPORATION
INDIVIDUAL ADDRESS & DOB OR CUSTOMER LOCATION	富山県射水市 庄西町1-3 -20 1958.2.4(DOB)	富山県射水市 七美中町200 2007.6.8 設立	富山県射水市 小杉白石604-1 2002.3.12 設立	富山県射水市 七美34 2001.10.2 設立(法人成り)
PLACE OF INCORPORATION				射水市
NATURE OF BUSINESS	会社員	中古車販売	中古車販売	中古車販売
BENEFICIAL OWNERS				ラヒール アッパル 1961.10.1 (DOB)
REASON FOR THE TRANSFER	該当した分を 特定(日付、 金額)してその お返しと不詳	中古車販売 代金	中古車販売 代金	中古車販売 代金
DOES THE BANKS DUE DILIGENCE	4先とも普通(総合)口座のみであり、他の使権 使済は存在しません。			
RELATIONSHIP BETWEEN THE ORGANIZATION	普通 ↑ 特に問題あり という意味	元買取あり。	元買取あり 当行行員訪問	元買取あり
他の情報	個人 会社員 有)スキーム 勤務	株式会社	有限会社	有限会社

以上の情報を支店が持っている。

富山県 射水市 (IMIZU-CITY) 庄西町 (SHOSAI-MACHI)

三ヶ (SANGA)

読みかた

TOTAL P.01

	De Araujo Roseli Aparecida	Aksys Corporation	R S Corporation	Sanhu Corp Imizi-shi Shitim
Address	1-3-20, Shoseimachi, Imizu-shi, Toyama Pref, Japan	200 Shichimi Nakano, Imizu-shi, Toyama Pref, Japan	608-1 Kosugishiraishi, Imizu-shi, Toyama Pref, Japan	34 Shichimi, Imizu-shi Toyama Pref, Japan
Postal Code	934-0001	933-0253	939-0304	933-0252
Date of Establishment	04Feb1958	08Jun2007	12Mar2002	02Oct2001
Place of Incorporation	-	-	-	Imizu-shi, Toyama Pref
Nature of Business	Business man	Sales of Used Cars	Sales of Used Cars	Sales of Used Cars
Beneficial Owners	-	-	-	Raheel Akutal (???) * not sure about the spelling (date of birth: 01Oct1961)
Reason for Transfer(s)	TC is required in order to identify the reason for transfer	Sales of Used Cars	Sales of Used Cars	Sales of Used Cars
Bank's Due Diligence	N/A (They maintain a savings account only.)			
Relationship between Originator	Satisfactory (no issues)	Purchase of TC (* Visit made by Hokuriku staff.)	Purchase of TC (* Visit made by Hokuriku staff.)	Purchase of TC (* Visit made by Hokuriku staff.)
AOB	The owner works with a company called Sugimoto.	Public company	Company with limited liability	Company with limited liability



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Occ-Psi-00808695  
From: ANTHONY JULIAN/HBUS/HSBC  
Sent: 11/13/2008 8:39:04 AM  
To: DENIS E O'BRIEN/HBUS/HSBC@HSBC02; JUDY P STOLDT/HBUS/HSBC@HSBC02  
CC:  
Subject: Fw: Hokuriku Bank  
Machiko M YAMASHITA/TKY/HBAP/HSBC@HSBC  
09/12/2008 06:52 AM

To  
Anthony Julian/HBUS/HSBC@HSBC02  
CC  
Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC, Alan P Williamson/HBUS/HSBC@HSBC02, Cam  
ADAMS/PCM ASP/HBAP/HSBC@HSBC, Hideki MATSUMOTO/TKY/HBAP/HSBC@HSBC, Michael B  
Gallagher/HBUS/HSBC@HSBC02, Navin GUPTA/TKY/HBAP/HSBC@HSBC, Richard JAGGARD/PCM  
ASP/HBAP/HSBC@HSBC, Takahiko KANECHIKU/TKY/HBAP/HSBC@HSBC, Thomas W  
Halpin/HBUS/HSBC@HSBC02  
Subject  
Fw: Hokuriku Bank

Anthony

My apologies. I sent mistakenly to Julian Anthony.

Sorry and Regards

Yamashita

----- Forwarded by Machiko M YAMASHITA/TKY/HBAP/HSBC on 2008/09/12 19:49 -----

Machiko M YAMASHITA/TKY/HBAP/HSBC  
12 Sep 2008 19:01 Mail Size: 35523  
Phone No. 813 5203 3328

To  
Julian H ANTHONY/PFS PUN/HBAP/HSBC@HSBC  
CC  
Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC, Alan P Williamson/HBUS/HSBC@HSBC02, Cam  
ADAMS/PCM ASP/HBAP/HSBC@HSBC, Hideki MATSUMOTO/TKY/HBAP/HSBC@HSBC, Michael B  
Gallagher/HBUS/HSBC@HSBC02, Navin GUPTA/TKY/HBAP/HSBC@HSBC, Richard JAGGARD/PCM  
ASP/HBAP/HSBC@HSBC, Takahiko KANECHIKU/TKY/HBAP/HSBC@HSBC, Thomas W  
Halpin/HBUS/HSBC@HSBC02  
Subject  
Fw: Hokuriku Bank

Our Ref

Your Ref

Anthony

we informed them that due to regulatory burden, HBUS decided to cease

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Permanent Subcommittee on Investigations  
**EXHIBIT #89**

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Occ-Psi-00808695

processing bulk TCS used for business purpose but continue processing other ordinary TCS. Also informed that this decision is not made only for the deals with Hokuriku Bank but also for any other banks.

Their response is as follows.

They wish you to allow respite until they will fix time frame to meet with your decision given the following internal situation at their end.

- First of all, they should consider whether or not they will continue dealing this business.  
- If they continue the business; 1) they have to select alternative provider. As you mentioned, it is true that there are several candidates in Japan but it may not be easy for them to select the most appropriate provider as they should consider pricing, procedure and etc through selecting process; and 2) they need to change their internal system and procedure. (As mentioned in my previous LN, their systems including accounting system are arranged to deal with HBUS. They also have to change their procedure manual etc. to meet with the alternative provider's processing manner.)  
- As you may be aware, September is the month for their interim fiscal period and due to this, it is one of the busiest months for Hokuriku Bank (not only for them but also for Japanese banks).

As to sort out TCS which HBUS can continuously deal with, they wish to know the clear definition of bulk TCS

We suggest that we should withdraw very carefully given the fact that Japanese regional banks' world is very small. If we will push Hokuriku drastically, HSBC may likely have bad reputation on our PCM business in this marketplace. Your feedback would be appreciated.

Regards

Yamashita

----- Forwarded by Machiko M YAMASHITA/TKY/HBAP/HSBC on 2008/09/12 18:55 -----

Anthony Julian/HBUS/HSBC@HSBC02  
12 Sep 2008 06:48 Mail Size: 30103

To  
Machiko M YAMASHITA/TKY/HBAP/HSBC@HSBC  
CC  
Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC, Alan P Williamson/HBUS/HSBC@HSBC02, Cam ADAMS/PCM ASP/HBAP/HSBC@HSBC, Hideki MATSUMOTO/TKY/HBAP/HSBC@HSBC, Michael B Gallagher/HBUS/HSBC@HSBC02, Navin GUPTA/TKY/HBAP/HSBC@HSBC, Richard JAGGARD/PCM ASP/HBAP/HSBC@HSBC, Takahiko KANECHIKU/TKY/HBAP/HSBC@HSBC, Thomas W Halpin/HBUS/HSBC@HSBC02  
Subject  
Re: Fw: Hokuriku Bank

Our Ref

Your Ref

Please note that HBUS senior management has reviewed this service extensively  
Page 2

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Occ-Psi-00808695

and determined that we can not continue to support this business. This is not an issue for negotiation with Hokuriku. HBUS has decided to withdraw from processing bulk quantities of TCs, as the regulatory burden is costly and the operational / regulatory risk is not acceptable.

We respect Hokuriku's perspective, and 30 days notification should be acceptable for withdrawal of services (as stated in our cash letter documentation).

As Cash Letter is a manual process, there should be no significant systemic issues with them shifting this business to another provider. Hokuriku maintains accounts with all of the major USD service providers (Citi, Chase, BONY, Wachovia, Deutsche, Amex, etc), each of whom offer competitive Cash Letter services. They can shift this business relatively easily, and we would appreciate their cooperation in ceasing bulk TC deposit as soon as possible. We will return bulk TC deposits received by HBUS after October 12.

Thanks and best regards

Anthony Julian  
First Vice President  
HSBC Bank USA, N.A.  
Global Transaction Banking  
Office: (302) 327-2665  
Mobile (BB): [REDACTED]

[REDACTED] = Redacted by the Permanent  
Subcommittee on Investigations

Machiko M YAMASHITA/TKY/HBAP/HSBC@HSBC  
09/11/2008 05:07 AM

To  
Alan P Williamson/HBUS/HSBC@HSBC02  
cc  
Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC, Anthony Julian/HBUS/HSBC@HSBC02, Cam  
ADAMS/PCM ASP/HBAP/HSBC@HSBC, Michael B Gallagher/HBUS/HSBC@HSBC02, Richard  
JAGGARD/PCM ASP/HBAP/HSBC@HSBC, Takahiko KANECHIKU/TKY/HBAP/HSBC@HSBC, Thomas W  
Halpin/HBUS/HSBC@HSBC02, Navin GUPTA/TKY/HBAP/HSBC@HSBC, Hideki  
MATSUMOTO/TKY/HBAP/HSBC@HSBC  
Subject  
Fw: Hokuriku Bank

Dear Alan

Matsumoto-san and myself visited Mr. Takahashi, GM and Mr. Takarada, Deputy MGR of International Operations Center to advise of your decision.

We conveyed the message that we understand that AML process is appropriately taken by Hokuriku Bank as Anthony commented and the point we intended to discuss is how we enhance process to avoid unnecessary internal process on our side.

During the discussion, we confirmed again the background of relevant transactions.

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Occ-Psi-00808695

- Most of their customers related to this issue are used-car dealers for Russian buyers who are cash account holders of Hokuriku Bank through appropriate AML process.

- The dealers are doing cash on delivery type of deals with buyers in this market therefore cash or TCS are normally used to accommodate those deals. As such Hokuriku Bank considers it is difficult for its customers to shift their payment method to wire transfers or commercial check from TCS.

- HBUS is currently the sole Cash Letter provider for Hokuriku Bank and if we stop providing this service to Hokuriku Bank, it needs reasonable grace period to find out alternative service provider and re-adjust its system which is currently arranged/designed to meet HBUS's requirement and also make sure the new internal process with all relevant branches/offices.

- Since relevant customers are limited around 20 - 25 names and they are all cash account holders of Hokuriku Bank, Hokuriku Bank is well prepared to cooperate with HBUS by providing necessary information / arranging operational process in order to help HBUS to streamline the process. As such if there are any measures to reduce your processing burden, they are open to discuss on that. For that, they wish to understand what is exactly the issue in your processing of the TCS in problem. They have already been following your requirement on high value deposit (exceeding USD20k per deposit), under which they have been providing their customers' information including name, address and business as well as amount and number of TCS. If HBUS requires further more information and/or different process, Hokuriku Bank is ready to discuss on that.

Your feedback would be appreciated.

Regards

Machiko Yamashita, FIG TKY

----- Forwarded by Machiko M YAMASHITA/TKY/HBAP/HSBC on 2008/09/11 17:34 -----

Alan P Williamson/HBUS/HSBC@HSBC02  
11 Sep 2008 01:22 Mail Size: 18427

To  
Hideki MATSUMOTO/TKY/HBAP/HSBC@HSBC, Navin GUPTA/TKY/HBAP/HSBC@HSBC, Machiko  
M  
YAMASHITA/TKY/HBAP/HSBC@HSBC  
CC  
Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC, Anthony Julian/HBUS/HSBC@HSBC02, Cam  
ADAMS/PCM ASP/HBAP/HSBC@HSBC, Michael B Gallagher/HBUS/HSBC@HSBC02, Richard  
JAGGARD/PCM ASP/HBAP/HSBC@HSBC, Takahiko KANECHIKU/TKY/HBAP/HSBC@HSBC, Thomas W  
Halpin/HBUS/HSBC@HSBC02  
Subject  
Re: Hokuriku Bank

Our Ref

Your Ref

Gentlemen

Page 4

Occ-Psi-00808695

Can I ask for the status on this matter?

Thank you all for your help.

Alan

----- Original Message -----

From: Hideki MATSUMOTO  
Sent: 09/05/2008 09:35 AM ZET  
To: Navin GUPTA; Machiko M YAMASHITA  
Cc: Ako KOBAYASHI; Alan P Williamson; Anthony Julian/HBUS/HSBC/HSBCAMERICAS; Cam ADAMS; Michael Gallagher; Richard JAGGARD; Takahiko KANECHIKU; Thomas W Halpin  
Subject: Re: Hokuriku Bank

Navin

RM is Yamashita san for Hokuriku Bk.

Yamashita san

it seems internal due date is tight for them to change structure involving their own clients. shall we move quickly to discuss on this with Hokuriku Bk.  
rgds, hideki

Navin GUPTA/TKY/HBAP/HSBC  
05 Sep 2008 08:29 Mail Size: 14141  
Phone No. 813 5203 4252

To  
Takahiko KANECHIKU/TKY/HBAP/HSBC@HSBC, Hideki MATSUMOTO/TKY/HBAP/HSBC@HSBC  
Cc  
Alan P Williamson/HBUS/HSBC@HSBC02, Anthony Julian/HBUS/HSBC@HSBCAMERICAS,  
Cam  
ADAMS/PCM ASP/HBAP/HSBC@HSBC, Michael B Gallagher/HBUS/HSBC@HSBC02, Richard  
JAGGARD/PCM ASP/HBAP/HSBC@HSBC, Thomas W Halpin/HBUS/HSBC@HSBC02, Ako  
KOBAYASHI/TKY/HBAP/HSBC@HSBC  
Subject  
Re: Hokuriku Bank

Our Ref

Your Ref

Kanechiku san,

Request your support in communication to Hokuriku bank as below.

Warm Rgs, Navin

1022

Occ-Psi-00808695

Fred SHYUR/PCM ASP/HBAP/HSBC  
09/05/2008 07:40 AM  
Mail Size: 3916

To  
Cam ADAMS/PCM ASP/HBAP/HSBC@HSBC, Navin GUPTA/TKY/HBAP/HSBC@HSBC, Anthony  
Julian/HBUS/HSBC@HSBCAMERICAS@REPUBLIC  
cc  
Thomas W Halpin/HBUS/HSBC@HSBC02, Michael B Gallagher/HBUS/HSBC@HSBC02,  
Richard  
JAGGARD/PCM ASP/HBAP/HSBC@HSBC, Alan P Williamson/HBUS/HSBC@HSBC02  
Subject  
Re: Hokuriku Bank  
Our Ref  
Your Ref

Cam and Navin,

FYI. Please kindly work with Anthony and Alan on the AML issue below.

Regards,

Fred Shyur

\*\*\*\*\*  
The Hongkong and Shanghai Banking Corporation Limited  
whose registered address is 1 Queen's Road Central, Hong Kong  
\*\*\*\*\*

----- Original Message -----

From: Alan P Williamson  
Sent: 09/04/2008 11:05 AM EDT  
To: Anthony Julian/HBUS/HSBC@HSBC02; Fred SHYUR  
Cc: Thomas W Halpin/HBUS/HSBC@HSBC02; Michael B Gallagher/HBUS/HSBC@HSBC02  
Subject: Hokuriku Bank

Anthony, Fred

As you may know, Compliance meets monthly with senior management in the Payments and Cash Management AML Management Review Committee. Recently we discussed the fact that Hokuriku has been sending a large number of sequential traveller's checks from a number of similar businesses through cash letter here in the US. This use of cash letter is inappropriate and the Committee has concluded that PCM should no longer allow Hokuriku to send traveler's checks through cash letter. Hokuriku should therefore cease the activity and make alternative arrangements, such as to make the deposits by wire, by September 30. Can I ask you to contact the appropriate RM's to convey this message to Hokuriku and confirm back that they have done so?

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Occ-Psi-00808695  
Thanks for your help. Please let me know if you have any questions.

Alan Williamson  
PCM Compliance  
212 525 8043

Page 7

1024

Occ-Psi-00811358  
From: DENIS E O'BRIEN/HBUS/HSBC  
Sent: 12/19/2008 11:16:25 AM  
To: AKO KOBAYASHI/TKY/HBAP/HSBC@HSBC03  
CC: ANTHONY JULIAN/HBUS/HSBC@HSBC02; DENISE A REILLY/HBUS/HSBC@HSBC02; HIDEKI MATSUMOTO/TKY/HBAP/HSBC@HSBC03;  
JONATHAN DEAN/HBUS/HSBC@HSBC02; JUDY P STOLDT/HBUS/HSBC@HSBC02; MACHIKO M YAMASHITA/TKY/HBAP/HSBC@HSBC03;  
SAEKA TAKEBAYASHI/TKY/HBAP/HSBC@HSBC03; SHINJI KAWAMURA/TKY/HBAP/HSBC@HSBC03; STEPHANIE K BROWN/HBUS/HSBC@HSBC02;  
TAKAO TAKENAKA/TKY/HBAP/HSBC@HSBC03; WILLIAM WEHMEYER/HBUS/HSBC@HSBC02  
Subject: Re: Fw: Hokuriku Bank - information needed

We are appreciative of your assistance and thank you for your diligence in this regard. We have closed our investigation as it relates to this issue.

Thanks and regards,

Denis E O'Brien

Vice President, Head of Global Transaction Banking Compliance, | HSBC Securities (USA) Inc.  
452 Fifth Avenue, New York, NY 10018

Phone. 212 525 1147  
Fax. 917-229-5257  
Mobile. [REDACTED]  
Email. denis.e.o'brien@us.hsbc.com

[REDACTED] = Redacted by the Permanent Subcommittee on Investigations

Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC03  
12/19/2008 02:00 AM

To  
Denis E O'Brien/HBUS/HSBC@HSBC02  
Cc  
Denise A Reilly/HBUS/HSBC@HSBC02, Hideki MATSUMOTO/TKY/HBAP/HSBC@HSBC03,  
Jonathan Dean/HBUS/HSBC@HSBC02, Judy P Stoldt/HBUS/HSBC@HSBC02, Machiko M YAMASHITA/TKY/HBAP/HSBC@HSBC03, Saeaka TAKEBAYASHI/TKY/HBAP/HSBC@HSBC03,  
Stephanie K Brown/HBUS/HSBC@HSBC02, William Wehmeyer/HBUS/HSBC@HSBC02, Anthony Julian/HBUS/HSBC@HSBC02, Takao TAKENAKA/TKY/HBAP/HSBC@HSBC03, Shinji KAWAMURA/TKY/HBAP/HSBC@HSBC03  
Subject  
Fw: Hokuriku Bank - information needed

Denis,

Hokuriku Bank has provided the information at their risk and confirmed that the purchasers of the travelers checks - Alexander Tokarenko, Andrey Davydov, Yuriy Zimchuk, Leonid Efimovich Egorov, Kopychev Valery or Bulgarov Maxim; are not signers or are NOT connected in any way to the previously requested named relationships at Hokuriku Bank. This should be the last favour and we cannot expect further or next assistance from them.

Page 1  
Permanent Subcommittee on Investigations  
EXHIBIT #90



1025

Best regards,

Occ-Psi-00811358

Ako KOBAYASHI  
Assistant Vice President | Global Payments and Cash Management, Asia Pacific  
HSBC Building, 3-11-1 Nihonbashi, Chuo-ku, Tokyo 103-0027, Japan

Phone. 813 5203 3161  
Fax. 813 5203 4236  
Email. ako.kobayashi@hsbc.co.jp

----- Forwarded by Ako KOBAYASHI/TKY/HBAP/HSBC on 2008/12/19 15:58 -----

Shinji KAWAMURA/TKY/HBAP/HSBC@HSBC03  
17 Dec 2008 17:11 Mail Size: 59442

To  
Denis E O'Brien/HBUS/HSBC@HSBC02  
cc  
Denise A Reilly/HBUS/HSBC@HSBC02, Hideki MATSUMOTO/TKY/HBAP/HSBC@HSBC03,  
Jonathan Dean/HBUS/HSBC@HSBC02, Judy P Stoldt/HBUS/HSBC@HSBC02, Machiko M  
YAMASHITA/TKY/HBAP/HSBC@HSBC03, Saeka TAKEBAYASHI/TKY/HBAP/HSBC@HSBC03,  
Stephanie K Brown/HBUS/HSBC@HSBC02, William Wehmeyer/HBUS/HSBC@HSBC02, Ako  
KOBAYASHI/TKY/HBAP/HSBC@HSBC03@HSBC, Anthony Julian/HBUS/HSBC@HSBC02, Takao  
TAKENAKA/TKY/HBAP/HSBC@HSBC03  
Subject  
Fw: Hokuriku Bank - information needed

Our Ref

Your Ref

Denis,  
I am Shinji Kawamura, MLCO in Japan.  
They have been good enough to provide information so far but as you may  
understand from bank secrecy view point, they should not or cannot disclose  
customer information. So they will no longer provide information. If you need  
my suggestion to clear those backlogs, I will tell you that you should file  
suspicious transaction report to your authority.

Regards,  
Shinji Kawamura  
Money Laundering Control Officer  
The Hongkong and Shanghai Banking Corporation, Tokyo  
TEL : 813-5203-3364  
FAX : 813-5203-3794

----- Forwarded by Shinji KAWAMURA/TKY/HBAP/HSBC on 2008/12/17 16:49 -----

Takao TAKENAKA/TKY/HBAP/HSBC  
17 Dec 2008 08:31 Mail Size: 54754

To  
Shinji KAWAMURA/TKY/HBAP/HSBC@HSBC03  
cc

Page 2

1026

Subject Occ-Psi-00811358  
Fw: Hokuriku Bank - information needed

Our Ref  
Your Ref

----- Forwarded by Takao TAKENAKA/TKY/HBAP/HSBC on 12/17/2008 08:30 AM -----

Denis E O'Brien/HBUS/HSBC@HSBC02  
17 Dec 2008 03:03 Mail Size: 54194

To  
Takao TAKENAKA/TKY/HBAP/HSBC@HSBC03  
CC  
Denise A Reilly/HBUS/HSBC@HSBC02, Hideki MATSUMOTO/TKY/HBAP/HSBC@HSBC03,  
Jonathan Dean/HBUS/HSBC@HSBC02, Judy P Stoldt/HBUS/HSBC@HSBC02, Machiko M  
YAMASHITA/TKY/HBAP/HSBC@HSBC03, Saeka TAKEBAYASHI/TKY/HBAP/HSBC@HSBC03,  
Stephanie K Brown/HBUS/HSBC@HSBC02, William Wehmeyer/HBUS/HSBC@HSBC02, Ako  
KOBAYASHI/TKY/HBAP/HSBC@HSBC03@HSBC, Anthony Julian/HBUS/HSBC@HSBC02  
Subject  
Re: Fw: Hokuriku Bank - information needed

Our Ref  
Your Ref

Takao,

By way of introduction, I am responsible for Global Transaction Banking  
Compliance in the U.S.

Ako Kobayashi has been very helpful thus far in assisting us in obtaining  
additional information as it relates to Hokuriku Bank customers that were  
utilizing our Cash Letter (Pouch) services. In response to the additional  
questions Hokuriku Bank has requested for our specific request:

1. The reason you are reviewing transaction from first and second quarter of  
2008 at this time of the year.  
Internal backlogs
2. Where did you get the name of the 30 companies?  
From Hokuriku Bank bulk deposits
3. Are you only asking Hokuriku Bank to provide such information?  
Yes, as it relates to Hokuriku Bank transactions
4. What would be the course of action you would take if any of the Russians are

Page 3

Occ-Psi-00811358

related in any way with the named relationships?  
(repeat of previous response)

We are required to understand and vet transactions processed that are alerted in our systems because of patterns or trends. To the best of our knowledge, we are unaware of any pending criminal act and would appreciate any information that can be shared with us regarding any law enforcement actions. The Russian names were identified during our due diligence as purchasers of travelers checks on behalf of third parties that used the items to purchase goods from your clients. Our request for information directly relates to transactions processed and alerted in our systems because of the large volumes, this processing is normal as we review in arrears and currently are backlogged reviewing transactions from first and second quarter of 2008. These investigations are time consuming as in most instances, like this one, we need to rely on our customers to provide additional information.

5. What is the reason for the request when there is no more outstanding travelers checks with Hokuriku Bank  
To clear the pending HBUS system generated alerts on previous activity.

We understand from the previous e-mails that Hokuriku Bank has requested some time to gather information for us, which we greatly appreciate and understand that we cannot expect completion by year-end. Again, we cannot stress enough, that all we are asking is confirmation that the purchasers of the travelers checks - Alexander Tokarenko, Andrey Davydov, Yuriy Zimchuk, Leonid Efimovich Egorov, Kopychev Valery or Bulgarov Maxim; are not signers or are connected in any way to the previously requested named relationships at Hokuriku Bank.

Thanks and regards,

Denis E O'Brien

Vice President, Head of Global Transaction Banking Compliance, | HSBC  
Securities (USA) Inc.  
452 Fifth Avenue, New York, NY 10018

Phone. 212 525 1147  
Fax. 917-229-5257  
Mobile. [REDACTED]  
Email. denis.e.o'brien@us.hsbc.com

Redacted by the Permanent  
Subcommittee on Investigations

Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC03  
12/15/2008 01:43 AM

To  
Denis E O'Brien/HBUS/HSBC@HSBC02@HSBC  
Cc  
Denise A Reilly/HBUS/HSBC@HSBC02, Jonathan Dean/HBUS/HSBC@HSBC02, Judy P Stoldt/HBUS/HSBC@HSBC02, Saeka TAKEBAYASHI/TKY/HBAP/HSBC@HSBC03, Stephanie K Brown/HBUS/HSBC@HSBC02, William Wehmeyer/HBUS/HSBC@HSBC02, Machiko M YAMASHITA/TKY/HBAP/HSBC@HSBC03, Hideki MATSUMOTO/TKY/HBAP/HSBC@HSBC03  
Subject  
Fw: Hokuriku Bank - information needed

Page 4

Occ-Psi-00811358

Denis,

Please be advised that other contact of Hokuriku Bank called us today and he has requested for further background for your specific request. The reason you are reviewing transaction from first and second quarter of 2008 at this time of the year.

Where did you get the name of the 30 companies?  
 Are you only asking Hokuriku Bank to provide such information?  
 What would be the course of action you would take if any of the Russians are related in any way with the named relationships?  
 What is the reason for the request when there is no more outstanding travelers checks with Hokuriku Bank

Please be advised that apparently they are not very happy with your request as they have other matters to attend toward the end of the year. Besides they are only given a very short timeframe.

Hokuriku Bank is not saying that they will not assist you to provide the required information however they are upset with the nature of the request without being given sufficient background. Given the nature of the queries, please understand it is time consuming and consider to allow them more time. They might not be able to supply the information by the end of the year.

Appreciate your understanding on the above.

Best regards,

Ako KOBAYASHI  
 Assistant Vice President | Global Payments and Cash Management, Asia Pacific  
 HSBC Building, 3-11-1 Nihonbashi, Chuo-ku, Tokyo 103-0027, Japan

Phone. 813 5203 3161  
 Fax. 813 5203 4236  
 Email. ako.kobayashi@hsbc.co.jp

----- Forwarded by Ako KOBAYASHI/TKY/HBAP/HSBC on 2008/12/15 14:58 -----

Ako KOBAYASHI/TKY/HBAP/HSBC  
 11 Dec 2008 14:24 Mail Size: 40837  
 Phone No. 813 5203 3161

To  
 Denis E O'Brien/HBUS/HSBC@HSBC02@HSBC  
 cc  
 Denise A Reilly/HBUS/HSBC@HSBC02, Jonathan Dean/HBUS/HSBC@HSBC02, Judy P Stoldt/HBUS/HSBC@HSBC02, Saeka TAKEBAYASHI/TKY/HBAP/HSBC@HSBC03, Stephanie K Brown/HBUS/HSBC@HSBC02, William Wehmeyer/HBUS/HSBC@HSBC02  
 Subject  
 Re: Fw: Hokuriku Bank - information needed

our Ref

Page 5

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Occ-Psi-00811358

Your Ref

Denis,

I have had dialogues with the Hokuriku Bank and they do not appear to retain ownership information. According to the client, they have identified the name of the branches where those named entities maintain an account with and shall shortly make a request to each branch to supply them with the required information.

Please bear with us some time for the Hokuriku Bank to complete the whole process.

Best regards,

Ako KOBAYASHI  
Assistant Vice President | Global Payments and Cash Management, Asia Pacific  
HSBC Building, 3-11-1 Nihonbashi, Chuo-ku, Tokyo 103-0027, Japan

---

Phone. 813 5203 3161  
Fax. 813 5203 4236  
Email. ako.kobayashi@hsbc.co.jp

---

Denis E D'brien/HBUS/HSBC@HSBC02  
11 Dec 2008 14:12 Mail Size: 35895

To  
Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC03@HSBC, Stephanie K Brown/HBUS/HSBC@HSBC02  
CC  
Denise A Reilly/HBUS/HSBC@HSBC02, Jonathan Dean/HBUS/HSBC@HSBC02, Judy P  
Stoldt/HBUS/HSBC@HSBC02, Saeka TAKEBAYASHI/TKY/HBAP/HSBC@HSBC03, William  
Wehmeyer/HBUS/HSBC@HSBC02  
Subject  
Re: Fw: Hokuriku Bank - information needed

Dur Ref

Your Ref

Thanks Ako,

I may be missing something here, all we are asking is if any of the named individuals are owners or account signers in the named entities. Doesn't Hokuriku Bank retain ownership information & signature cards on there customers.

Please advise as we would appreciate closing this investigation out before year end.

Page 6

1030

Occ-Psi-00811358

Thanks,  
Denis O'Brien  
Vice President  
Head of GTB Compliance  
Tel: (212) 525-1147  
Cell [REDACTED]  
Cell [REDACTED]

[REDACTED] = Redacted by the Permanent  
Subcommittee on Investigations

----- Original Message -----  
From: Ako KOBAYASHI  
Sent: 12/11/2008 01:54 PM ZE9  
To: Stephanie Brown  
Cc: Denis O'Brien; Denise Reilly; Jonathan Dean; Judy Stoldt; Saeka  
TAKEBAYASHI/TKY/HBAP/HSBC@HSBC03; William Wehmeyer  
Subject: Re: Fw: Hokuriku Bank - information needed  
Stephanie,

I have called Hokuriku Bank and was advised to allow some time. As they do not know how those Russian names are pronounced, Hokuriku Bank needs to visit the companies listed below one by one and it would certainly require certain amount of time. Please consider to wait till the end of this year.

Appreciate your understanding.

Best regards,

Ako KOBAYASHI  
Assistant Vice President | Global Payments and Cash Management, Asia Pacific  
HSBC Building, 3-11-1 Nihonbashi, Chuo-ku, Tokyo 103-0027, Japan

Phone. 813 5203 3161  
Fax. 813 5203 4236  
Email. ako.kobayashi@hsbc.co.jp

Stephanie K Brown/HBUS/HSBC@HSBC02  
11 Dec 2008 05:41 Mail Size: 31533

To  
Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC03  
Cc  
Saeka TAKEBAYASHI/TKY/HBAP/HSBC@HSBC03, Judy P Stoldt/HBUS/HSBC@HSBC02@HSBC,  
Denise A Reilly/HBUS/HSBC@HSBC, Jonathan Dean/HBUS/HSBC@HSBC, William  
Wehmeyer/HBUS/HSBC@HSBC, Denis E O'Brien/HBUS/HSBC@HSBC  
Subject  
Re: Fw: Hokuriku Bank - information needed

Our Ref  
Your Ref

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Occ-Psi-00811358

Hello Ako,

Do you have any information concerning the below matter?

Please note it is imperative that we received an answer as soon as possible.

Thanks and regards,

Stephanie K Brown  
HSBC Bank USA, National Association  
Account Manager | GPCM Client Services  
90 Christiana Road, New Castle, De. 19720

Phone 0302 327 2291  
Fax 212 642 4065  
Email stephanie.k.brown@us.hsbc.com

Hello Ako,

Here is additional information concerning our questions related to Hokuriku Bank:

The background of our queries stem from our requirement to understand and vet transactions processed that are alerted in our systems because of patterns or trends. To the best of our knowledge, we are unaware of any pending criminal act and would appreciate any information that can be shared with us regarding any law enforcement actions. The Russian names were identified during our due diligence as purchasers of travelers checks on behalf of third parties that used the items to purchase goods from your clients. Our request for information directly relates to transactions processed and alerted in our systems because of the large volumes, this processing is normal as we review in arrears and currently are backlogged reviewing transactions from first and second quarter of 2008. These investigations are time consuming as in most instances, like this one, we need to rely on our customers to provide additional information.

Your immediate attention would be greatly appreciated in advising us if Alexander Tokarenko, Andrey Davydov, Yuriy Zimchuk, Leonid Efimovich Egorov, Kopychev Valery or Bulgarov Maxim are signers or are connected in any way to the previously requested named relationships at Hokuriku Bank.

Thanks in advance your assistance in this regard.

Thanks and regards,

Stephanie K Brown  
HSBC Bank USA, National Association  
Account Manager | GPCM Client Services  
90 Christiana Road, New Castle, De. 19720

Phone 0302 327 2291  
Fax 212 642 4065  
Email stephanie.k.brown@us.hsbc.com

Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC03

Page 8

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12/03/2008 08:56 PM

Occ-Psi-00811358

To :  
gpcmcclientservices/HBUS/HSBC@HSBC02  
Cc :  
Saeka TAKEBAYASHI/TKY/HBAP/HSBC@HSBC03, Stephanie K Brown/HBUS/HSBC@HSBC02  
Subject :  
Fw: Hokuriku Bank - information needed

Stephanie,

Hokuriku Bank has raised the following questions:

What is the background for your queries? Does it relate to your compliance reason or does it relate to criminal act and the police asks such information? Where did you get those Russian names? Since no cheques has been presented to you since Nov08, why such information is required now?

Appreciate your feedback on the above.

Thanks and best regards,

Ako KOBAYASHI  
Assistant Vice President | Global Payments and Cash Management, Asia Pacific  
HSBC Building, 3-11-1 Nihonbashi, Chuo-ku, Tokyo 103-0027, Japan

Phone. 813 5203 3161  
Fax. 813 5203 4236  
Email. ako.kobayashi@hsbc.co.jp

----- Forwarded by Ako KOBAYASHI/TKY/HBAP/HSBC on 2008/12/04 10:50 -----

Ako KOBAYASHI/TKY/HBAP/HSBC  
01 Dec 2008 11:21 Mail Size: 20181  
Phone No. 813 5203 3161

To :  
gpcmcclientservices/HBUS/HSBC@HSBC02  
Cc :  
Saeka TAKEBAYASHI/TKY/HBAP/HSBC@HSBC03, Stephanie K Brown/HBUS/HSBC@HSBC02  
Subject :  
Re: Hokuriku Bank - information needed

Our Ref.

Your Ref.

Stephanie,

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Occ-Psi-00811358  
I have forwarded your message to Hokuriku Bank. Upon receipt of their reply, I shall revert to you.

Best regards,

Ako KOBAYASHI  
Assistant Vice President | Global Payments and Cash Management, Asia Pacific  
HSBC Building, 3-11-1 Nihonbashi, Chuo-ku, Tokyo 103-0027, Japan

---

Phone. 813 5203 3161  
Fax. 813 5203 4236  
Email. ako.kobayashi@hsbc.co.jp

---

gpcmcclientservices/HBUS/HSBC@HSBC02  
Sent by: stephanie K Brown@HSBC02  
29 Nov 2008 04:31 Mail Size: 16116

To  
Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC03  
Cc  
Saeka TAKEBAYASHI/TKY/HBAP/HSBC@HSBC03  
Subject  
Hokuriku Bank - information needed

Our Ref

Your Ref

Hello Ako,

Can you please contact Hokuriku Bank and request they provide us with the following information:

Please advise within a week if Alexander Tokarenko, Andrey Davydov, Yuriy Zimchuk, Leonid Efimovich Egorov, Kopychev Valery or Bulgarov Maxim are signers or are connected in any way to the following relationships at Hokuriku Bank:

MARIC TRADING CORPORATION  
I.K. AUTO LTD  
S.K. TRADING CO., LTD.  
DEAN CORPORATION CO LTD  
GONDAL CORPORATION  
SHIN KYOWA INTERNATIONAL  
JAMSOU TRADERS CO. LTD.  
CHOWDHURY TRADE INTL CO. LTD  
AWAN INTERNATIONAL K.K.  
SHIWA SANGYO CO. LTD  
CARLAND HOKURIKU CO.  
MALIK SEKINE BOEKI COMPANY  
SHAKI CORPORATION  
M.A AWAN CORPORATION  
AUTO SAM CO.

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Occ-Psi-00811358

A.S.U. CORPORATION  
P J ENTERPRISE  
SUNRISE TRADING CO LTD  
FRIENDSHIP MOTOR CAR K.K.  
SANDO CORPORATION  
GROMAKOV BORIS  
AUTO STAGE LTD.  
CHACHA ENTERPRISE CO., LTD.  
COSMOS CORPORATION  
JAPAN TREK INC  
KABIR AUTO EXPORT CO., LTD  
KG COMPANY CO., LTD  
SEIIN YONEDA  
SEKIZAWASYOUJI CO LTD  
ZHELOMKO RUSLAN

Feel free to contact me directly, if further information is needed.

Thanks and kind regards,

Stephanie Brown  
GPCM Client Services  
HSBC Bank USA, N.A.  
90 Christiana Rd., New Castle, DE 19720  
Telephone: 302 327 2171  
Facsimile: 212 642 4008

T- 3 inquiry.

Nanayo Ryan  
PCM Client Services | HSBC Bank USA NA  
90 Christiana Road, New Castle, DE 19720 U.S.A.

Phone. 302-327-2256  
Fax. 212-642-4065  
Email. nanayo.ryan@us.hsbc.com

----- Forwarded by Nanayo Ryan/HBUS/HSBC on 11/26/2008 01:12 PM -----

Judy P Stoldt/HBUS/HSBC  
11/26/2008 10:14 AM

To  
Nanayo Ryan/HBUS/HSBC@HSBC02  
cc  
William Wehmeyer/HBUS/HSBC@HSBC, Denis E O'Brien/HBUS/HSBC@HSBC  
Subject  
Fw: Hokuriku Bank

Nan,

Page 11

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Occ-Psi-00811358  
We do need the information so can you send the request to Hokuriku Bank? Keep us posted.

Judy P Stoldt  
Vice President, AML Compliance | HSBC Bank USA, National Association  
One HSBC Center  
Buffalo, New York 14203

---

Phone (716) 841- 6425  
Fax (212) 382 - 7586  
Email judy.p.stoldt@us.hsbc.com

----- Forwarded by Judy P Stoldt/HBUS/HSBC on 11/26/2008 10:14 AM -----

Judy P Stoldt/HBUS/HSBC  
11/24/2008 04:30 PM

To  
Nanayo Ryan/HBUS/HSBC  
CC  
Denis E O'Brien/HBUS/HSBC@HSBC, William Wehmeyer/HBUS/HSBC@HSBC  
Subject  
Fw: Hokuriku Bank

Nan,

We talked this over and can you hold this request until tomorrow. I'll let you if we need you to send it.

Judy P Stoldt  
Vice President, AML Compliance | HSBC Bank USA, National Association  
One HSBC Center  
Buffalo, New York 14203

---

Phone (716) 841- 6425  
Fax (212) 382 - 7586  
Email judy.p.stoldt@us.hsbc.com

----- Forwarded by Judy P Stoldt/HBUS/HSBC on 11/24/2008 04:29 PM -----

William Wehmeyer/HBUS/HSBC  
11/24/2008 04:15 PM

To  
Nanayo Ryan/HBUS/HSBC@HSBC  
CC  
Judy P Stoldt/HBUS/HSBC, Denis E O'Brien/HBUS/HSBC, Jonathan  
Dean/HBUS/HSBC@HSBC  
Subject  
Hokuriku Bank

1036

Occ-Psi-00811358

Nan,

Please reach out to Hokuriku Bank and request that they advise within a week if Alexander Tokarenko, Andrey Davydov, Yuriy Zimchuk, Leonid Efimovich Egorov, Kopychev Valery or Bulgarov Maxim are signers or are connected in any way to the following relationships at Hokuriku Bank:

MARIC TRADING CORPORATION  
I.K. AUTO LTD  
S.K. TRADING CO., LTD.  
DEAN CORPORATION CO LTD  
GONDAL CORPORATION  
SHIN KYOWA INTERNATIONAL  
JAMSOU TRADERS CO. LTD.  
CHOWDHURY TRADE INTL CO. LTD  
AWAN INTERNATIONAL K.K.  
SHIWA SANGYO CO. LTD  
CARLAND HOKURIKU CO.  
MALIK SEKINE BOEKI COMPANY  
SHAKI CORPORATION  
M.A AWAN CORPORATION  
AUTO SAM CO.  
A.S.U. CORPORATION  
P J ENTERPRISE  
SUNRISE TRADING CO LTD  
FRIENDSHIP MOTOR CAR K.K.  
SANDO CORPORATION  
GROMAKOV BORIS  
AUTO STAGE LTD.  
CHACHA ENTERPRISE CO., LTD.  
COSMOS CORPORATION  
JAPAN TREK INC  
KABIR AUTO EXPORT CO., LTD  
KC COMPANY CO., LTD  
SEIIN YONEDA  
SEKIZAWASYOUJI CO LTD  
ZHELOMKO RUSLAN

Please confirm to me when the message is sent and notify me on the response.  
Thank you for your assistance in this matter.

Regards,

William Wehmeyer  
AVP - AML Compliance Officer | HSBC Bank USA NA  
90 Christiana Road, New Castle, Delaware 19720

Phone. 302 327 2052  
Fax. 212-642-4013  
Email. william.wehmeyer@us.hsbc.com

**From:** Boss, Joseph  
**To:** DiLorenzo, Anthony;  
**cc:** [REDACTED] Boss, Joseph;  
**Subject:** SK Trading  
**Date:** Monday, December 01, 2008 10:48:54 AM

[REDACTED] = Redacted by the Permanent  
 Subcommittee on Investigations

Tony, HSBC Compliance management provided me with an update on the situation involving SK Trading.

If you recall, we uncovered huge amounts of [REDACTED] travelers' checks (daily averages of \$500M to \$700M per day) being processed by HSBC for their correspondent Hokuriku Bank in Japan. The travelers' checks were being processed in bulk and all checks were payable to SK Trading, with each bundle (average size of \$250M) signed by the same individual and in \$1000 denominations and sequentially numbered. We were informed that the aforementioned amounts we identified during our sampling was the peak amount sent in for processing for SK Trading.

We were informed that once [REDACTED] received a 314 request from HSBC regarding the matter, they [REDACTED] dispatched investigators to Russia to conduct surveillance at the bank in which the travelers' checks were being purchased. The result was that [REDACTED] identified five individuals who were purchasing the checks with cash at the Russian Savings Bank and signing the checks. In turn, the five individuals were providing the checks to Mr. Alexander Tokarenko who is the owner of SK Trading. Mr. Tokarenko then stamped the checks payable to SK Trading. HSBC identified all accounts, including SK Trading, at Hokuriku Bank that were forwarding bulk deposits of [REDACTED] travelers' checks to HSBC for clearing. There were 30 accounts at Hokuriku Bank that were sending bulk deposits of travelers' checks. HSBC is attempting to discern if Mr. Alexander Tokarenko has ownership interest in the other 29 entities. HSBC advised that the total dollar amount of bulk travelers' checks processed by HSBC for the 30 entities during the period of November 2007 to October 2008 was over \$61 million.

Recently, HSBC informed Hokuriku Bank that HSBC could no longer process travelers' checks for them. Once HSBC management ascertains if Mr. Alexander Tokarenko has ownership in any of the other entities, management will [REDACTED]

Please let me know if you require any further information.

Thanks, Joe

Permanent Subcommittee on Investigations  
 EXHIBIT #91

Confidential & Non-public OCC Inform

OCC-PSI-00888526

## FOX HORAN &amp; CAMERINI LLP

825 THIRD AVENUE  
NEW YORK, NEW YORK 10022ATTORNEYS AND COUNSELLORS  
AT LAWTELEPHONE: (212) 490-4600  
TELECOPIERS: (212) 268-2393  
(212) 709-0248

June 26, 2012

By Email and FedExZachary Schram, Esq.  
Senior Counsel  
Permanent Subcommittee on Investigations  
United States Senate  
Washington, D.C.Re: Questions Posed to the New York Representative Office  
Of The Hokuriku Bank, Ltd.

Dear Mr. Schram:

Our client, the Hokuriku Bank, Ltd. ("Hokuriku Bank") has asked us to respond to the questions you posed to it in your email of May 21, 2012. The information conveyed here came from our client.

Question 1What is Hokuriku's relationship with HSBC, including HSBC Bank USA (HBUS) ?

Hokuriku Bank's relationship began with HBUS's predecessor in interest, Marine Midland Bank, in May of 1973. In September of 1985, Hokuriku Bank and Marine Midland entered into an International Cash Letter Service Agreement, pursuant to which the two banks cleared travelers' checks for each other. In October of 2008, the bank, by then named HBUS, stopped clearing travelers' checks for Hokuriku Bank, and on May 21, 2012, HBUS terminated its relationship with Hokuriku Bank entirely.

Hokuriku Bank also has a correspondent relationship with Hong Kong and Shanghai Banking Corporation, Ltd. However, this relationship will be terminated by mutual consent on July 4, 2012.

Hokuriku Bank currently has a correspondent relationship with the four branches of HSBC Banking (China) Company, Ltd. pursuant to a Relationship Management Application ("RAM"). Hokuriku Bank also has a RAM arrangement with the Taiwan branch of HSBC (Taiwan) Ltd.

Hokuriku Bank also maintains correspondent relationships with HSBC Banking Middle East, Ltd. and HSBC Bank PLC (now known as HSBC PLC) pursuant to an agency agreement.

Permanent Subcommittee on Investigations
<b>EXHIBIT #92</b>

PSI-HokurikuBank-01-0001

Zachary Schram, Esq.  
 United States Senate  
 June 26, 2012  
 Page 2 of 4

Until May 29, 2012, Hokuriku Bank had a correspondent relationship with HSBC Malaysia Berhad, pursuant to a RAM.

**Questions 2 and 3**

**What is Hokuriku's experience with submitting U.S. dollar travelers' checks to HBUS for clearance from 2005 to the present, including the volume of checks submitted each year, why HBUS stopped processing the travelers' checks in 2008, and when and why HBUS restarted processing them.**

**Hokuriku's understanding of the travelers' checks cashed by clients in Russia involved in the used car business, HBUS's 2008 inquiry into those travelers' checks, and whether Hokuriku is still processing those checks.**

Due to the geographic proximity of Russia across the Sea of Japan, many Japanese dealers of pre-owned automobiles are located along the coast, including the Hokuriku region. (Hokuriku means "North Land" in Japanese). Hokuriku Bank is headquartered in this area and has several branches in the surrounding areas. Some of such dealers have accounts at Hokuriku Bank.

In a typical transaction, a customer of Hokuriku Bank (that is to say an account holder) sells a used car (or cars) to a Russian buyer who is a passenger or crew member of a ship at a nearby port. The buyer pays with travelers' checks. The seller/account holder brings the travelers' checks to its bank (Hokuriku) and deposits them into its account. Hokuriku Bank accepts the travelers' checks, credits the customer's account, and sends the checks to clearing banks. About 90% of the travelers' checks which were cleared by HSBC were in denominations of \$1,000 or \$500. All the travelers' checks were issued by American Express.

Until October of 2008, HBUS was the clearing bank for Hokuriku Bank in the U.S. HBUS would clear the checks and credit Hokuriku's correspondent account at HBUS. In or about October of 2008, HBUS notified Hokuriku Bank that it would no longer clear travelers' checks for Hokuriku Bank. The reason offered by HBUS was that the cost of processing the travelers' checks, especially the ones submitted by used car dealers, had become too high.

Hokuriku Bank then turned to Bank of New York Mellon which has been clearing the travelers' checks ever since. HBUS has not restarted clearing traveler's checks for Hokuriku Bank.

PSI-HokurikuBank-01-0002

Zachary Schram, Esq.  
 United States Senate  
 June 26, 2012  
 Page 3 of 4

Hokuriku Bank does not have "clients in Russia" who bring in travelers checks. The traveler's checks are brought in by Hokuriku's account holders which are companies incorporated under Japanese law. Hokuriku does not accept travelers' checks unless deposited by customers into existing accounts (other than travelers' checks total of which is less than \$1,000 brought in by individual tourists). Please refer to the attached document which is an excerpt of the compliance manual of Hokuriku Bank. The pages attached list identification and other documentation required the Hokuriku Bank in order for them to engage in various transactions, including processing traveler's checks.

Hokuriku Bank still accepts traveler's checks brought in by its customers, which are now sent to Bank of New York Mellon for clearance.

Hokuriku Bank does not have any knowledge regarding "HBUS's 2008 inquiry into those traveler's checks."

Please see the attachment for the volume of travelers' checks sent to HBUS for clearance each year.

#### Question 4

#### Whether Hokuriku clears its U.S. dollar travelers' checks with any bank other than HSBC

As stated above, The Bank of New York Mellon has been clearing Hokuriku's U.S. dollar travelers' checks since November 1, 2008.

#### Question 5

#### What is Hokuriku's KYC and AML practices?

Hokuriku Bank has established comprehensive Compliance Regulations to assure compliance with all applicable laws and regulations including, without limitation, the Laws Preventing Transfer of Profits Generated by Criminal Activities and the Foreign Exchange and Foreign Trade Control Law. Hokuriku Bank reviews and updates the Compliance Regulations annually and as required by law.

The legal section which is created within the Compliance Office is responsible for overseeing the bank compliance matters.

All branches perform internal inspection on a monthly basis to ensure their compliance pursuant to certain procedures set up by the bank. In addition, the Internal Auditing Department conducts thorough investigations of all bank activities including, without limitation, compliance with AML matters.

PSI-HokurikuBank-01-0003

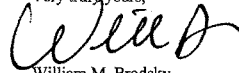


Zachary Schram, Esq.  
United States Senate  
June 26, 2012  
Page 4 of 4

Hokuriku Bank accepts U.S. dollar traveler's checks only on the following conditions:

- No more than \$1,000 per person per day.  
Two exceptions may apply:
  - (1) If a regular customer brings in a travelers' check in excess of \$1,000 and if by Hokuriku's judgment, it is deemed that the funds will be collected from the customer should it turn out that the travelers' check was not duly issued; or
  - (2) If the travelers' checks were issued by Hokuriku Bank.
- In either case, Hokuriku Bank requires an ID to clear travelers' checks in the excess of ¥2,000,000. (approximately \$25,000 at the exchange rate of \$1 = ¥80)
- Whenever someone who does not have an account at Hokuriku (such as a tourist or sailor) whose address is not verified brings in travelers' checks in denominations of \$500 or \$1,000 or more, Hokuriku would check if a lost or stolen report has been filed regarding them.
- Whenever a non-Japanese customer opens a new account, Hokuriku will confirm if the customer (as well as the person in charge in case of a corporate account) is subject to economic sanctions or their assets are frozen. The Hokuriku Bank has a database for such confirmations and performs searches based on the surname, given name, middle name and corporate name.

Very truly yours,



William M. Brodsky  
Chizuko S. Ueno

WMB:kg  
w/Encls.  
cc: Mr. Shigeo Hikage (w/o Encls.)

PSI-HokurikuBank-01-0004

*Volume of U.S.Dollar Travelers Checks  
to HBUS for Clearance by year*

THE HOKURIKU BANK,LTD  
International Department  
MAY 30 2012

		Volume(USD)	Clearing Bank
2005		76,983,897.00	HSBC Bank USA,N.A.
2006		71,802,654.00	
2007		90,248,281.00	
2008	to Oct	52,539,290.00	Bank of New York Mellon
	from Nov	3,992,610.00	
2009		7,031,660.00	
2010		10,598,030.00	
2011		7,991,460.00	
2012	to Apr	2,181,210.00	

1042

**From:** Schram, Zachary (HSGAC)  
**To:** Robertson, Mary (HSGAC)  
**Cc:** Stuber, Laura (HSGAC); Bean, Elise (HSGAC)  
**Subject:** FW: Hokuriku Bank  
**Date:** Friday, June 29, 2012 11:50:51 AM

---

**From:** William M. Brodsky [mailto:wmbrodsky@foxdex.com]  
**Sent:** Friday, June 29, 2012 11:07 AM  
**To:** Schram, Zachary (HSGAC)  
**Cc:** Chizuko S. Ueno  
**Subject:** Hokuriku Bank

Zach,

Here is our client's response to your queries:

1. When did the limits on the use of travelers checks mentioned in your answer to question 5 take effect?

The current policy has been in effect since 1984 or around that time,

2. Why do so many purchasers of used cars use travelers checks at Hokuriku?

The bank does not know why travelers checks were the primary method of payment in the past. Currently, most payment are being made by wire transfer.

3. How does Hokuriku receive travelers checks from its customers?

The customers (account holders) would bring them to the branch offices and give them to the tellers.

Bill Brodsky  
 Fox Horan & Camerini  
 825 Third Avenue  
 New York, NY 10022  
 212-480-4800

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1044

Occ-Psi-00318438  
From: ALAN P WILLIAMSON/HBUS/HSBC  
Sent: 8/27/2007 12:09:51 PM  
To: TERRY WESTREN/HBUS/HSBC@HSBC  
CC: CAROLYN M WIND/HBUS/HSBC@HSBC; CLARA HURTADO/HBUS/HSBC@HSBC; JEFF CLOUS/HBUS/HSBC@HSBC;  
LOUIS MARINO/HBUS/HSBC@HSBC; MANUEL DIAZ/HBUS/HSBC@HSBC; MARTIN HOLY/HBUS/HSBC@HSBC;  
STEFAN HARDY/HBUS/HSBC@HSBC; TERESA GARCIA/HBUS/HSBC@HSBC  
Subject: Re: Bearer Share Companies

Stefan

Note from Terry:

Alan,  
As requested, below is the list of New York Bearer Share accounts. It also gives the status of the documentation for these accounts and other information. The total is at the bottom of the spreadsheet.

Thanks and regards,

Terry Westren  
SVP, Head of International Operations, HSBC Private Bank  
452 Fifth Ave. 6th Floor, New York, N.Y. 10018

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Phone. 212-525-5325  
Fax. 212-525-1680  
Email. terry.westren@hsbcpb.com

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Terry Westren/HBUS/HSBC  
08/27/2007 01:00 PM

To: Stefan HARDY/HBUS/HSBC@HSBC  
Cc: Alan P Williamson/HBUS/HSBC@HSBC, Carolyn M Wind/HBUS/HSBC@HSBC, Clara Hurtado/HBUS/HSBC@HSBC, Jeff Clous/HBUS/HSBC@HSBC, Louis Marino/HBUS/HSBC@HSBC, Manuel Diaz/HBUS/HSBC@HSBC, Martin Holy/HBUS/HSBC@HSBC, Teresa Garcia/HBUS/HSBC@HSBC  
Subject: Re: Bearer Share Companies

Stefan,  
OK. I have already provided the information on Bearer Shares you requested to Alan. Do you need it as well?

Thanks and regards,

Terry Westren

Permanent Subcommittee on Investigations  
**EXHIBIT #93**

1045

Occ-Psi-00318438  
SVP, Head of International Operations, HSBC Private Bank  
452 Fifth Ave. 6th Floor, New York, N.Y. 10018

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Phone. 212-525-5325  
Fax. 212-525-1680  
Email. terry.westren@hsbcpb.com

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Stefan HARDY/HBUS/HSBC  
08/27/2007 12:49 PM

To  
Alan P Williamson/HBUS/HSBC@HSBC, Jeff Clous/HBUS/HSBC@HSBC, Terry  
westren/HBUS/HSBC@HSBC  
cc  
Carolyn M Wind/HBUS/HSBC@HSBC, Clara Hurtado/HBUS/HSBC@HSBC, Martin  
Holy/HBUS/HSBC@HSBC, Teresa Garcia/HBUS/HSBC@HSBC, Manuel Diaz/HBUS/HSBC@HSBC,  
Louis Marino/HBUS/HSBC@HSBC  
Subject  
Re: Bearer Share Companies

Thank you Alan.

Jeff - do you have a similar policy for new and existing a/cs?

Terry - I will call you to bring you up to speed with the meeting we had this morning. Can you provide a summary analysis of bearer share accounts for NY and the status for BOLs, shares in custody etc for new and existing a/cs as required by the policy listed below please?

Stefan Hardy  
SVP, PB US Risk Management  
New York

---

Phone. 212-525-0392

---

Alan P Williamson/HBUS/HSBC  
08/27/2007 12:30 PM

To  
Stefan HARDY/HBUS/HSBC@HSBC  
cc  
Carolyn M Wind/HBUS/HSBC@HSBC, Teresa Garcia/HBUS/HSBC@HSBC, Clara  
Hurtado/HBUS/HSBC@HSBC, Martin Holy/HBUS/HSBC@HSBC  
Subject  
Bearer Share Companies

Page 2

Occ-Psi-00318438

The following is our current policy for Bearer Share Corporations in NY:

New Clients: For this purpose, new clients are considered to be new relationships to HSBC.

Bearer Share corporations will only be accepted if:

- CEO - NY IPB and AML LCO approval is received; and,
- Client commits to registering the shares or the shares are held in custody with an approved non-US resident third party custodian, who is authorized to advise HSBC of any changes in ownership

Existing clients:

If an existing client opens an account with a Bearer Share Corporation, then the Existing Clients section noted below applies:

For Bearer Share corporations classified as "high-risk"(see below), the client either must commit to converting the corporation to a registered share corporation or the bearer shares are held in custody with HSBC or an approved non-US resident third party custodian, who is authorized to advise HSBC of any changes in ownership. For all other Bearer Share corporations, the Beneficial Ownership letter must be completed and renewed every three years.

Each of the factors noted below will be considered in determining if the Bearer Share account should be classified high-risk:

- Risk classification of ultimate beneficial owner/decision maker
- Involvement of HSBC in the creation of the Bearer Share corporation (if HSBC created the corporation, the Relationship Manager will already have significant knowledge of the client)
- Number of accounts the Bearer Share client maintains (if the only account with HSBC is the PIC (Bearer Share corporation), then the client may be considered high risk)
- Length of time the Beneficial Owner of the Bearer Share corporation has been a client
- Level and nature of activity in the Bearer Share corporate account(s)

Exceptions:

Exceptions to this policy must be approved by any two of the following, one of whom must be the AML Officer: the CEO - NY IPB or designate, COO and Chief AML Officer, PB Americas.

Attachment: Bearer Shares Account Total.xls.zip

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[illegible]



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345	6/2/2003	12/29/2004	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	17/2/2005	British Virgin Islands	12,899,244.92								6,477,714.53		
346	4/2/2003	11/26/2003	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	11/2/2005	Uruguay	132,718.17								132,718.17		
347	8/7/2003	3/1/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	3/1/2005	Uruguay	2,553,824.00								2,553,824.00		
348	8/7/2003	3/1/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	10/2/2005	Uruguay	35,344.58								35,344.58		
349	11/2/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Update Required	27/2/2004	Uruguay	535,115.16								535,115.16		
350	3/27/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	4/7/2005	British Virgin Islands	33,233,515.93								33,233,515.93		
351	12/23/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	8/15/2005	British Virgin Islands	14,841.39								14,841.39		
352	12/23/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	4/2/2007	Uruguay	2,501.15								2,501.15		
353	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	3/1/2007	Paraguay	138,393.97								138,393.97		
354	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	17/2/2005	Uruguay	1,698,344.16								1,698,344.16		
355	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	3/1/2005	Uruguay	5,156,476.77								5,156,476.77		
356	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	10/1/2007	British Virgin Islands	13,251,189.47								13,251,189.47		
357	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	12/11/2005	Paraguay	29,687.72								29,687.72		
358	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	2/7/2007	Uruguay	4,521.69								4,521.69		
359	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	2/7/2007	Uruguay	1,203,343.49								1,203,343.49		
360	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	8/27/2007	Paraguay	5,138,594.16								5,138,594.16		
361	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	8/27/2007	Paraguay	4,135,655.41								4,135,655.41		
362	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	10/2/2005	Paraguay	1,779,248.46								1,779,248.46		
363	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	2/2/2006	Paraguay	3,143,118.00								3,143,118.00		
364	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	8/22/2007	Paraguay	3,617,388.31								3,617,388.31		
365	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	8/22/2007	Paraguay	454,129.46								454,129.46		
366	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	12/2/2004	Paraguay	250,322.06								250,322.06		
367	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	12/2/2004	Uruguay	28,727.46								28,727.46		
368	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	10/2/2005	British Virgin Islands	5,295.00								5,295.00		
369	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	14/2/2005	Uruguay	8,829.12								8,829.12		
370	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	27/2/2005	British Virgin Islands	2,383,956.14								2,383,956.14		
371	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	6/27/2005	British Virgin Islands	2,113,988.70								2,113,988.70		
372	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	6/2/2005	Uruguay	6,000.00								6,000.00		
373	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	10/1/2005	British Virgin Islands	22,460.00								22,460.00		
374	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	8/1/2005	Uruguay	820,495.14								820,495.14		
375	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	8/1/2005	British Virgin Islands	3,195,889.52								3,195,889.52		
376	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	8/1/2005	Uruguay	1,390,071.97								1,390,071.97		
377	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	12/2/2005	Paraguay	1,454,608.72								1,454,608.72		
378	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	12/2/2005	Uruguay	278,783.03								278,783.03		
379	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	12/2/2005	Paraguay	18,382.71								18,382.71		
380	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	3/1/2005	Paraguay	731,456.03								731,456.03		
381	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	6/2/2007	British Virgin Islands	25,217.49								25,217.49		
382	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	4/1/2005	Uruguay	1,151,350.00								1,151,350.00		
383	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	5/22/2004	Uruguay	208,433.52								208,433.52		
384	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	1/2/2005	British Virgin Islands	1,182,238.39								1,182,238.39		
385	10/14/2003	8/7/2005	001 BENEFICIAL OWNERSHIP LETTER - Senior Share	Current	8/27/2005	British Virgin Islands	5,013.93								5,013.93		

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Officer	Grat	Customer	Open Date	Document Description	Status (Current)	Meeting	Share Date	Country of Origin Date	Share Date	Country of Origin Date	Share Date	AUM Total	Grat
632	2	Open Date	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Current		9/15/2003	British Virgin Islands	9/15/2003	British Virgin Islands	9/15/2003	664,637.97	632
633	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Current		9/15/2003	British Virgin Islands	9/15/2003	British Virgin Islands	9/15/2003	1,250,211.63	633
634	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Current		9/15/2003	British Virgin Islands	9/15/2003	British Virgin Islands	9/15/2003	3,894,341.63	634
635	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	3,524,656.36	635
636	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	2,797,959.36	636
637	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	2,911,119.36	637
638	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	686,154.98	638
639	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	1,312,137.93	639
640	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	4,400.35	640
641	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	1,027,288.44	641
642	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	2,487,237.27	642
643	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	651,225.92	643
644	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	495,116.62	644
645	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	1,052,413.36	645
646	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	3,001.47	646
647	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	3,634,164.44	647
648	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	4,617,430.33	648
649	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	2,369,910.52	649
650	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	1,634,291.44	650
651	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	538,888.88	651
652	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	687,633.11	652
653	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	4,023,314.10	653
654	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	1,437,870.26	654
655	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	1,634,291.44	655
656	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	3,171,341.63	656
657	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	1,379,730.09	657
658	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	1,352,411.44	658
659	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	3,984,144.44	659
660	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	2,632,365.31	660
661	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	8,183,188.19	661
662	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	3,917,247.66	662
663	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	442,785.66	663
664	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	2,329,638.66	664
665	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	822,278.78	665
666	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	1,616,728.39	666
667	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	3,715,511.22	667
668	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	4,454,544.47	668
669	2	6/1/1998	6/1/1998	2011 BENEFICIAL OWNERSHIP LETTER - Beaver Shares	Update Required		12/6/2003	British Virgin Islands	12/6/2003	British Virgin Islands	12/6/2003	1,414,131.47	669

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8/20/1996	8/20/1996	8/20/1996	8/20/1996	8/20/1996	8/20/1996	8/20/1996	8/20/1996	8/20/1996	8/20/1996	8/20/1996	8/20/1996
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Occ-Psi-00226652

From: JEFF CLOUS/HBUS/HSBC  
Sent: 12/11/2007 4:13:08 PM  
To: PAUL J O'SULLIVAN/HBUS/HSBC@HSBC02  
CC: ALAN P WILLIAMSON/HBUS/HSBC@HSBC;MANUEL DIAZ/HBUS/HSBC@HSBC;TERRY WESTREN;LOUIS MARINO/HBUS/HSBC  
Subject: Re: Fw: Bearer Share Corporation Policy

Paul, attached are my comments on the draft Bearer Share Policy that I had previously sent to Alan in September.  
As you know, IPB Miami has ceased accepting Bearer Share company accounts so draft requirements for establishing new bearer share accounts are not relevant. IPB Miami maintains existing accounts for 1,679 Bearer Share Corporations of which 126 are considered High Risk. (See attached report.) These companies hold \$2.6 billion in PUM and generate an estimated revenue of \$26 million per year.

# Bearer Share	PUM Bearer Share	Est. Margin	Estimated Rev
1679	2,626,134,512	1.00%	26,261,345

I believe there would be a significant impact to the IPB business if we enacted the draft policy of requiring all existing bearer shares to be held in custody by the end of next year.

I would question why the draft policy would require BOTH holding bearer shares in custody and re-certifying the beneficial ownership letter every three years. That seems to go beyond the expectation of the regulators. As I pointed out below, the interagency examination manual has clearly stated that periodic re-certification of the beneficial ownership of bearer share accounts is acceptable for well known established customers. (The average age of the Miami bearer share relationships is 13 years.)

I would also question the timing of the draft policy, which requires existing Bearer Share companies to convert to registered shares or be held in custody by the end of 2008, a year ahead of the BVI regulations requiring the same steps at the end of 2009. This would take a major effort on our part to accomplish and would disadvantage long standing HSBC clients many of which HSBC has assisted in establishing their company.

Is there any room to revise this policy or obtain a dispensation for IPB?

Regards,

Jeff Clous, SVP

IPB Operations

1441 Brickell Avenue, 16th Floor, Miami, Florida 33131

(305) 539-4810 (Phone) (305) 374 6466 (Fax)

Alan with respect to existing bearer share accounts the BSA/AML EXAMINATION MANUAL has changed their comment on the mitigation of risk of bearer share accounts. In 2005 - custody was the only option. This changed in 2006/7 and re-certification is acceptable.

EXAMINERS MANUAL 2005 - BEARER SHARE

If ownership is held in bearer share form, the bank should maintain the physical control of the bearer shares either inhouse or with a trusted third party to ensure that the ownership of the corporate entity does not change without the bank's knowledge.

Page 1

Permanent Subcommittee on Investigations

EXHIBIT #94

1060

Occ-Psi-00226652

EXAMINERS MANUAL 2006/7 - BEARER SHARE  
If ownership is held in bearer share form, banks should assess the risks these relationships pose and determine the appropriate controls. For example, banks may choose to maintain (or have an independent third party maintain) bearer shares for new clients, or those without well established relationships with the institution.

For well-known, established customers, banks may find that periodically recertifying beneficial ownership is effective.

Regards,  
Jeff Clous, SVP  
IPB Operations  
1441 Brickell Avenue, 16th floor, Miami, Florida 33131  
(305) 539-4810 (Phone) (716) 626 6922 (Fax)

Paul J O'Sullivan/HBUS/HSBC@HSBC02  
12/10/2007 06:36 PM

To  
Terry Westren/HBUS/HSBC@HSBC, Mason C Salit/HBUS/HSBC@HSBC02, Teresa Garcia/HBUS/HSBC@HSBC02, Antonio Suarez-Obregon/HBUS/HSBC@HSBC, Jeff Clous/HBUS/HSBC@HSBC, Manuel Diaz/HBUS/HSBC@HSBC, Clara Hurtado/HBUS/HSBC@HSBC, Patrick M Campion/HBUS/HSBC@HSBC, Steven J Rockefeller/HBUS/HSBC@HSBC, Dennis J Duggan/HBUS/HSBC@HSBC  
cc  
Marlon Young/HBUS/HSBC@HSBC, Louis Marino/HBUS/HSBC@HSBC, Alan P Williamson/HBUS/HSBC@HSBC  
Subject  
Fw: Bearer Share Corporation Policy

All,

Attached is the final draft of proposed policy covering Bearer Share Company clients. There is a little more flexibility than was originally planned and we will be able to maintain bearer share company accounts once the requirements of the policy are met.

I will follow up with each group individually (DPB, IPB NY, and IPB Miami) to discuss implementation steps.

regards,  
Paul  
----- Forwarded by Paul J O'Sullivan/HBUS/HSBC on 12/10/2007 06:21 PM -----

Ali S Kazmy/HBUS/HSBC@HSBC  
12/10/2007 04:38 PM

To  
Paul J O'Sullivan/HBUS/HSBC@HSBC02  
cc  
Subject  
Bearer Share Corporation Policy

Page 2

1061

Occ-Psi-00226652

Attached is the aforementioned document for implementation purposes. Please note that we will be announcing the policy by the end of the week.

[attachment "Bearer Share Corporation Account Policy Guidance (Final Draft 082907).doc.zip" deleted by Jeff Clous/HBUS/HSBC]

In case of any questions, please let me know.

Regards,

Attachment: All Bearer Share Accounts.pdf.zip

Mr. Cohen: Hello

Claude: Yes, Mr. Cohen, you're sure that Gregoire told you that?

Mr. Cohen: Why? Yes.

Claude: He told you that he'll set up a Panamanian company for you [again]?

Mr. Cohen: A Panamanian, he gave me names and everything.

Claude: He gave you names too?

Mr. Cohen: Yes, Panamanian companies.

Claude: Because it's... sooner or later you are going to register Mr. Cohen, it's better to have registered shares.

Mr. Cohen: I don't want registered shares. If I place relatives as assignees, I don't want these assignees one day saying that the money is theirs.

Claude: [sighs]

Mr. Cohen: Eh yes, do you understand?

Claude: Yes, I see, but because sooner or later, it's going to be registered, do you understand Mr. Cohen? That's why, why you will pay money, now you will pay money all over again.

Mr. Cohen: So what do you want? That I close the account with you and that I go to Gregoire?

Claude: I didn't say that, but I didn't say that you should close the account...

Mr. Cohen: I can't do that.

Claude: ...close the account.

Mr. Cohen: Neither Safra nor Gregoire told me that. It's just you telling me that.

Claude: That what?

Mr. Cohen: Maybe in Geneva it can't exist...

Claude: ...but Mr. Cohen, I am honestly telling you that if it isn't today, its tomorrow, or the day after, it's going to be...

Permanent Subcommittee on Investigations  
**EXHIBIT #95**

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HSBC-PSI-PROD-0024791

Mr. Cohen: Maybe in the United States, but not New York... in Geneva.

Claude: Alright, do you want to speak with Evelyne and have her better explain it to you?

Mr. Cohen: No, I do not want to speak with her [laughs]. Why?

Claude: OK, listen, I will verify with compliance and compliance will verify with Geneva if it's OK to open Panamanians and that's it.

Mr. Cohen: Check, and check if the laws in Switzerland are different than American laws.

Claude: The laws in Switzerland are different than those in the United States, we are going to verify that Mr. Cohen. Believe me, I'm doing the best for you, that's why I am going to ask.

Mr. Cohen: And older companies, no.

Claude: Older companies what.

Mr. Cohen: They don't need to register.

Claude: No, no, no, older companies no, but now new companies are asked to, all of them are going to be registered, all.

Mr. Cohen: But older companies, no.

Claude: No.

Mr. Cohen: So, I still have the old ones.

Claude: Yes, but this has nothing to do with the old ones. Now you want to open for....

Mr. Cohen: ...no I can give you an old one.

Claude: Panamanian?

Mr. Cohen: Yes, there are old Panamanians.

Claude: I'll ask ...

Mr. Cohen: I have old ones that are ten and fifteen years old.

Claude: Ten and fifteen years old, but there always needs to be a new tarifficator, good standing, a new this, a new that, a new this, what do we...If it's ten years old, there is a new certificate of good standing.

Mr. Cohen: Yes.

Claude: There is a new...some new, the...new secretaries. (Inaudible) you know that the directors, bosses, have changed? Of the...of that company.

Mr. Cohen: Yeah, so?

Claude: And so it would need a new director, the list of new directors, the list of new ones...so it's the same thing. You need to open a new one...there needs to be a new one.

Mr. Cohen: There needs to be shareholders.

Claude: Yes.

Mr. Cohen: I'll give you the beneficial owner, but I do not want the shares to be in the name of the beneficial owner.

Claude: No, you can... you can diversify the shares.

Mr. Cohen: And so?

Claude: That means that the hundred, [inaudible] you can give all of the names, that one, that one, that one, that one.

Mr. Cohen: And so?

Claude: It's easier than giving it to just one.

Mr. Cohen: Wait, wait a minute, but the shares, you have to, you want shares?

Claude: No, you will have the originals, but you can put for example X - M. Leon - 40; Sonia - 50...

Mr. Cohen: But I can't put that, otherwise I have to declare them in the United States? I can't do that, I don't want to declare...otherwise, I have to close the accounts with you and go to Geneva.

Claude: Yes, I see, I see what you want...

Mr. Cohen: I can't do that because we, I'm a resident here.



Claude: Yes.

Mr. Cohen: Why do you think I put Habib...

Claude: Yes, right, right.

Mr. Cohen: ...my brother-in-law, he's...he agrees with me. It's not like I'm doing it without...

Claude: OK, OK, alright, I understand, I understand.

Mr. Cohen: He gives me his passport, he gives me everything.

Claude: OK so you... you absolutely want to change to Panamanian. OK, I'll ask, I'll ask compliance and we'll see, alright and I will call you back.

Mr. Cohen: Keep me posted because [inaudible]... Geneva is free.

Claude: OK, I will keep you posted. He gave you names too?

Mr. Cohen: He gave me names; he's going to make them companies.

Claude: Alright, OK, I will ask and I will call you back.

Mr. Cohen: OK.

Claude: Bye bye.

Mr. Cohen: Talk to you soon.

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HSBC-PSI-PROD-0024794

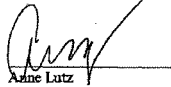


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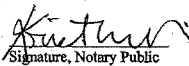
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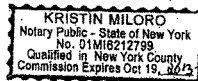
City of New York, State of New York, County of New York

I, Anne Lutz, hereby certify that the document "C. Mandel 04/25/2007 11:32:53 AM  
(43452433\_C\_Mandel\_4\_15\_07 to 5\_5\_07 XV\_2DD.wav.zip)" is, to the best of my  
knowledge and belief, a true and accurate translation from French to English.

  
Anne Lutz

Sworn to before me this  
November 23, 2009

  
Signature, Notary Public



Stamp, Notary Public

THREE PARK AVENUE, 39TH FLOOR, NEW YORK, NY 10016 T 212.689.5555 F 212.689.1059 WWW.TRANSPerfect.COM

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HSBC-PSI-PROD-0024795

From: TERESA GARCIA/HBUS/HSBC  
Sent: 6/20/2007 4:05:47 PM  
To: ALAN P WILLIAMSON/HBUS/HSBC@HSBC  
CC:  
Subject: Re: Waiver Request

OCC-Psi-00214516

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Subcommittee on Investigations

Alan,

That's where my problem comes in.

The policy reads:

For new Relationships: Bearer Share corporations will only be accepted if:  
· CEO - NY IPB and AML LCO approval is received; and,  
· Client commits to registering the shares or the shares are held in  
custody with an approved non-US resident third party custodian, who is  
authorized to advise HSBC of any changes in ownership. (see Procedures)

In this case, the client does not want to commit to either option. That's why  
Manuel suggested if we can give them a waiver to the above. We are talking  
about a potential client with an estimated net worth is in excess of [REDACTED]  
million in liquid assets.

Would having a conference call with Manuel, the RM and the two of us help?

We always try to work with the business, but sometimes we just can't.

Thanks

Teresa Garcia  
Senior Manager Specialized Compliance  
HSBC Private Bank New York  
452 Fifth Ave., T6, NY, NY 10018  
(PH)212-525-6014 (F) 212-525-8255

Alan P Williamson/HBUS/HSBC  
06/20/2007 04:43 PM

To  
Teresa Garcia/HBUS/HSBC@HSBC  
CC  
Subject  
Re: Waiver Request

Teresa

Thanks. Is there a procedure for waiving bearer shares - i.e. do Manuel & I  
have the authority?

Alan

Teresa Garcia/HBUS/HSBC  
06/20/2007 01:44 PM

Permanent Subcommittee on Investigations  
EXHIBIT #96a

1068

Occ-Psi-00214516

To  
Alan P. Williamson/HBUS/HSBC@HSBC  
CC  
Subject  
Re: Waiver Request

Following are the RM responses:

The name of the accounts are:  
- Urigeler International S.A. - Holding Company  
- Birmingham Merchant S.A. - Holding Company

These two are companies that were established several years ago in Panama,  
which establishes companies with bearer shares.

Thanks

Teresa Garcia  
Senior Manager Specialized Compliance  
HSBC Private Bank New York  
452 Fifth Ave., T6, NY, NY 10018  
(PH)212-525-6014 (F) 212-525-8255

Alan P. Williamson/HBUS/HSBC  
06/20/2007 11:15 AM

To  
Teresa Garcia/HBUS/HSBC@HSBC  
CC  
Subject  
Re: Waiver Request

Teresa

Thanks for the info. What are the bs companies and why are they bs?

Alan

From: Teresa Garcia  
Sent: 06/20/2007 09:58 AM EDT  
To: Alan P. Williamson  
Subject: Fw: Waiver Request

Alan,

I would like to discuss with you. The RM is anxious for an answer since he is  
Page 2

Occ-Psi-00214516  
traveling to meet the client next week.

Thanks.

Teresa Garcia  
Senior Manager Specialized Compliance  
HSBC Private Bank New York  
452 Fifth Ave., T6, NY, NY 10018  
(PH) 212-525-6014 (F) 212-525-8255

----- Forwarded by Teresa Garcia/HBUS/HSBC on 06/20/2007 09:57 AM -----

Teresa Garcia/HBUS/HSBC  
06/14/2007 03:14 PM

To  
Susan Hoggarth/HBUS/HSBC  
cc

Subject  
Waiver Request

Sue,

Jaime Carvallo is looking to open a relationship for [REDACTED]. The two accounts are bearer shares. The client does not want neither to register nor custodize the shares, and they do not want to sign the BOL.

Jaime and I have discussed this issue with Manuel Diaz. Manuel is willing to sign a waiver in order to open the two accounts, as he is very familiar with the family and interested in establishing a relationship with them. I also know the family very well since I worked for [REDACTED] for 19 years. I have personally met [REDACTED]. Here is a brief summary of [REDACTED].

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Subcommittee on Investigations

1070

Occ-Psi-00214516

Please let me know what your thoughts are.

Thank you.

Teresa Garcia  
Senior Manager Specialized Compliance  
HSBC Private Bank New York  
452 Fifth Ave., T6, NY, NY 10018  
(PH) 212-525-6014 (F) 212-525-8255

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Subcommittee on Investigations

Page 4

1071

Occ-Psi-00214534

From: ALAN P WILLIAMSON/HBUS/HSBC  
Sent: 6/20/2007 5:48:38 PM  
To: MANUEL DIAZ/HBUS/HSBC@HSBC  
CC:  
Subject: Re: Fw: Waiver Request

I thought so. I would do it without going to Geneva but audit wrote up DPB on a similar situation.

Alan

Manuel Diaz/HBUS/HSBC  
06/20/2007 06:32 PM

To  
Alan P Williamson/HBUS/HSBC@HSBC  
CC  
Subject  
Re: Fw: Waiver Request

I FULLY SUPPORT THIS WAIVER

Manuel L. Diaz  
President & Managing Director  
HSBC Private Bank International  
1441 Brickell Ave. 17th Floor  
Miami, FL 33131  
(305) 539-4747 Telephone

Alan P Williamson/HBUS/HSBC  
06/20/2007 06:28 PM

TO  
Manuel Diaz/HBUS/HSBC@HSBC, Marlon Young/HBUS/HSBC@HSBC  
CC  
Teresa Garcia/HBUS/HSBC@HSBC, Susan Hoggarth/HBUS/HSBC@HSBC  
Subject  
Fw: Waiver Request

Manuel, Marlon

I have no objection to this request, however I believe the requirement to register bearer shares is a group mandate. I understand the process to be that if you want an exception we will have to go to Geneva. I am willing to pass on

Permanent Subcommittee on Investigations  
EXHIBIT #96b

1072

the request if that is what you want. Occ-Psi-00214534

Thanks

Alan

----- Forwarded by Alan P Williamson/HBUS/HSBC on 06/20/2007 06:24 PM -----

Teresa Garcia/HBUS/HSBC  
06/20/2007 05:29 PM

To  
Alan P Williamson/HBUS/HSBC@HSBC  
cc

Subject  
Re: Waiver Request

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Subcommittee on Investigations

Alan,

Because they wish to maintain confidentiality, and they have never been asked by our competitors with whom they bank to do this. The [REDACTED] is the most visible and influential family [REDACTED]

Teresa

Alan P Williamson/HBUS/HSBC  
06/20/2007 05:21 PM

To  
Teresa Garcia/HBUS/HSBC@HSBC  
cc

Subject  
Re: Waiver Request

Teresa

why do they not want to register or deposit the shares?

Alan

Teresa Garcia/HBUS/HSBC  
06/20/2007 01:44 PM

To  
Alan P Williamson/HBUS/HSBC@HSBC  
cc

Page 2



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Subcommittee on Investigations

Occ-Psi-00214880

From: ALAN P WILLIAMSON/HBUS/HSBC  
Sent: 6/26/2007 4:24:22 PM  
To: JAIME CARVALLO/HBUS/HSBC; MARLON YOUNG/HBUS/HSBC; "MANUEL DIAZ"  
<MANUEL.DIAZ@HSBCPB.COM>;  
"TERESA GARCIA" <TERESA.GARCIA@HSBCPB.COM>; "SUSAN HOGGARTH"  
<SUSAN.HOGGARTH@US.HSBC.COM>  
Subject: Re: [REDACTED] Family

Marlon, Manuel, Jaime

I spoke to Susan Wright, Group Head of AML. She is reluctant to grant the exception but will consider it.

Jaime

Could I ask you to prepare a summary of the proposed relationship again, including details of the family and their businesses. Please specifically address whether there are any undisclosed ownership interests or political connections with these accounts. Circulate it to this group for review.

I know you already did something of this - no reason you can't re-use most of it.

Alan

From: Jaime Carvallo  
Sent: 06/26/2007 02:23 PM EDT  
To: Marlon Young  
Cc: Alan P Williamson  
Subject: Re: [REDACTED] Family

Marlon,

I forgot to mention again that this family's liquid net worth is estimated in excess of [REDACTED] and total net worth in the [REDACTED] \$ area.

I hope this can be done.

Thank you again for your help.

Warm regards

Jaime

From: Marlon Young  
Sent: 06/25/2007 06:33 PM EDT  
To: Jaime Carvallo  
Cc: Teresa Garcia; Thomas Flory; Ana Da Silva; Alan P Williamson  
Subject: Re: [REDACTED] Family

I have discussed w Terry and Alan Williamson and will give my support to this exception. Sorry, I was in a rush to leave Friday, I forgot to send my approval.  
Regards,  
Marlon

From: Jaime Carvallo  
Sent: 06/25/2007 01:48 PM EDT  
To: Marlon Young  
Cc: Teresa Garcia; Thomas Flory; Ana Da Silva

Page 1

Permanent Subcommittee on Investigations  
**EXHIBIT #97a**

1074

Subject: [REDACTED] Family

Occ-Psi-00214880

[REDACTED] = Redacted by the Permanent  
Subcommittee on Investigations

Marlon,

Teresa Garcia must have given you heads up on the [REDACTED] family and the issue regarding their holding companies having bearer shares and the fact that they will not sign the BOL.

I will see one of the family members tomorrow morning and this still seems to have no resolution. This is too important a family in Peru for us not to want to do business with, and one that has taken a lot of my time and effort to convince to start a relationship with us. Joao Luiz has met members of the family as well. I would appreciate your involvement at this point, as this has become extremely sensitive.

Thank you and regards,

Jaime

Page 2

1075

From: TERESA GARCIA/HBUS/HSBC  
Sent: 7/5/2007 11:33:35 AM  
To: ALAN P WILLIAMSON/HBUS/HSBC@HSBC  
CC: SUSAN HOGGARTH/HBUS/HSBC@HSBC  
Subject: Re: Fw: Fw: Fw: [REDACTED] Family

Occ-Psi-00215211

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Subcommittee on Investigations

Alan,

Not quite resolved yet, but there is nothing else for us to do. The RM and the Group Head are not seeing eye to eye on this one. Therefore, it is now between them.

I'll keep you posted.

Teresa Garcia  
Senior Manager Specialized Compliance  
HSBC Private Bank New York  
452 Fifth Ave., T6, NY, NY 10018  
(PH) 212-525-6014 (F) 212-525-8255

Alan P Williamson/HBUS/HSBC  
07/03/2007 04:30 PM

To  
Marlon Young/HBUS/HSBC@HSBC, Jaime Carvallo/HBUS/HSBC@HSBC, Manuel  
Diaz/HBUS/HSBC@HSBC, Thomas Flory/HBUS/HSBC@HSBC  
CC  
Teresa Garcia/HBUS/HSBC@HSBC, Susan Hoggarth/HBUS/HSBC@HSBC  
Subject  
Re: Fw: Fw: Fw: [REDACTED] Family

All

Just checking to see if this is going well or if there is anything more you need us to do.

Have a good holiday

Alan

Marlon Young/HBUS/HSBC  
06/29/2007 05:33 AM

To  
Jaime Carvallo/HBUS/HSBC@HSBC, Teresa Garcia/HBUS/HSBC@HSBC  
CC  
Manuel Diaz/HBUS/HSBC, Alan P Williamson/HBUS/HSBC@HSBC, Thomas  
Flory/HBUS/HSBC@HSBC  
Subject  
Fw: Fw: Fw: [REDACTED] Family

Page 1

Permanent Subcommittee on Investigations  
**EXHIBIT #97b**

Occ-Psi-00215211

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---

Jaime and Terry,  
 See if you can work within the MLPP policy on bearer shares.

Regards,  
 Marlon

From: David Ford  
 Sent: 06/29/2007 10:17 AM CEST  
 To: Alan P Williamson  
 Cc: Marlon Young; Manuel Diaz  
 Subject: Re: Fw: Fw: [REDACTED] Family

Alan,

Attached is the relevant MLPP policy which allows either BO declaration or holding the shares by HSBC or third party banks. The MLPP provides significant flexibility since the shares can also be held by other banks acceptable to HSBC. As long as US requirements are not more stringent than our GPB KYC policy, suggest that USPB offer the client the choice of the various options under the policy.

Regards,

David

[attachment "MLPP-Bearer share.doc" deleted by Alan P Williamson/HBUS/HSBC]

F. David Ford  
 Global Money Laundering Control Officer  
 HSBC Private Banking Holdings (Suisse) SA  
 Rue de Lausanne 18-20  
 Geneva, Switzerland 1211  
 Tel: 41-58-705-5284

Alan P Williamson/HBUS/HSBC  
 28.06.2007 19:18

To  
 "David Ford" <david.ford@hsbcpb.com>  
 cc  
 Subject  
 Fw: Fw: [REDACTED] Family

David

Does the suggestion referred to in Jaime's email below seem viable? Sorry to keep bothering you, I didn't realise we might have so many issues.

Alan

1077

Occ-Psi-00215211

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Subcommittee on Investigations

From: Manuel Diaz  
Sent: 06/28/2007 11:49 AM EDT  
To: Marlon Young  
Cc: Alan P Williamson; Jaime Carvallo  
Subject: Re: Fw: [REDACTED] Family

THANK YOU MARLON FOR YOUR INTEREST .....ENJOY YOUR VACATION !!!!!

Manuel L. Diaz  
President & Managing Director  
HSBC Private Bank International  
1441 Brickell Ave. 17th Floor  
Miami, FL 33131  
(305) 539-4747 Telephone

Marlon Young/HBUS/HSBC  
06/28/2007 09:58 AM

To:  
Jaime Carvallo/HBUS/HSBC@HSBC  
Cc:  
Manuel Diaz/HBUS/HSBC@HSBC, Alan P Williamson/HBUS/HSBC@HSBC  
Subject:  
Re: Fw: [REDACTED] Family

Jaime,  
This could be a good compromise and could resolve our problem.  
Marlon

From: Jaime Carvallo  
Sent: 06/28/2007 09:47 AM EDT  
To: Marlon Young  
Cc: Manuel Diaz  
Subject: Re: Fw: [REDACTED] Family

Marlon,

I have asked Teresa for a draft of a letter that client could sign in lieu of the BOL, as have few clients in the past. While the letter states similar information to that in the BOL is kept separately from account opening docs and may be a viable option. I am just waiting for her draft before trying anything else.

Thank you for your follow up!

Jaime

From: Marlon Young

Page 3

1078

Sent: 06/28/2007 03:39 AM EDT  
To: Jaime Carvallo  
Cc: Manuel Diaz  
Subject: Fw: [REDACTED] Family

OCC-Psi-00215211

[REDACTED] = Redacted by the Permanent  
Subcommittee on Investigations

Jaime -

Below is a response I receive from Mike Finamore who works for me in DPB. He used to be a senior AML specialist at Citigroup Private Bank. He is very familiar w KYC policies there and the policy on bearer shares.

Would any of the options suggested below work for the client? Would client allow us to keep bearer shares in safekeeping or execute a confidentiality agreement as suggested by Mike?

Regards,  
Marlon

From: Michael G Finamore  
Sent: 06/27/2007 10:38 PM EDT  
To: Marlon Young  
Subject: Re: Fw: [REDACTED] Family

Hi Marlon,

In this day, it is not likely that any US based Private Bank would allow an account to be opened without knowing all the owners unless an exception/dispensation was granted. Citi Private Bank would open an account for an entity whose shares were issued in bearer form for a client with an existing 2+ year relationship, but I never saw an exception requested because the client did not want to sign the Beneficial Ownership Letter.

Would this client feel more comfortable if we open the account for his bearer share entity without a BOL but he would allow us to hold the certificates in safekeeping? In that situation, we could make a very reasonable argument for dispensation.

Or would the client provide the BOL if we provide him a confidentiality agreement? There is an 'approved version' that we have used in the USPB, but I am certain Legal can tweak it to make the client feel more comfortable.

Hope this helps.

Thanks and regards,  
Michael Finamore, VP, CAMS  
Business Risk Officer  
HSBC PBUS  
Tower / 26th fl.  
NYC, NY, USA  
tel: 212-525-8451

Marlon Young/HBUS/HSBC  
06/27/2007 08:19 PM

To  
Michael G Finamore/HBUS/HSBC@HSBC  
CC

Subject  
Fw: [REDACTED] Family

Page 4

Occ-Psi-00215211

= Redacted by the Permanent  
 Subcommittee on Investigations

Here are more info regarding why the family will only provide bearer shares.  
 Marlon

From: Jaime Carvallo  
 Sent: 06/26/2007 01:47 PM EDT  
 To: Marlon Young  
 Cc: Teresa Garcia; Thomas Flory; Ana Da Silva; Alan P Williamson  
 Subject: Re: [REDACTED] Family

Marlon,

I met with the prospect today. While they understand our policy, he reiterated the family is extremely concerned about confidentiality and they are afraid this kind of information could put them at risk. He added that neither Citi nor JPMorgan (banks they have relationships with) have asked for them to sign a BOL. He does understand that eventually they will have to register the shares, but will only do it when absolutely necessary.

I wanted to add that another piece of business that is on the table, for which we only have one other bank competing, and which we have a good chance of winning since we were the first to approach them on, is to help them reorganize the family businesses, and facilitate the succession not only of their financial assets but also their operating companies. This could be a very significant piece of business. Not opening accounts will eliminate us from this business that is very strategic for the family and a way to deepen a relationship with them over time, and needless to say, very profitable.

Thank you for your help with this!

Regards,

Jaime

From: Alan P Williamson  
 Sent: 06/25/2007 06:54 PM EDT  
 To: Marlon Young; Jaime Carvallo  
 Cc: Teresa Garcia; Thomas Flory; Ana Da Silva  
 Subject: Re: [REDACTED] Family

Marlon

I apologise but I thought I forwarded you David Ford's response last week - I will again. Basically he wants us to get an exception from group. Since I happen to be with the head of group and I will ask her tom'w.

Alan

From: Marlon Young  
 Sent: 06/25/2007 06:33 PM EDT  
 To: Jaime Carvallo  
 Cc: Teresa Garcia; Thomas Flory; Ana Da Silva; Alan P Williamson  
 Subject: Re: [REDACTED] Family

I have discussed w Terry and Alan Williamson and will give my support to this  
 Page 5

Redacted by the Permanent  
Subcommittee on Investigations

Occ-Psi-00215211  
exception. Sorry, I was in a rush to leave Friday, I forgot to send my  
approval.  
Regards,  
Marlon

From: Jaime Carvallo  
Sent: 06/25/2007 01:48 PM EDT  
To: Marlon Young  
Cc: Teresa Garcia; Thomas Flory; Ana Da Silva  
Subject: [REDACTED] Family

Marlon,

Teresa Garcia must have given you heads up on the [REDACTED] family and the issue  
regarding their holding companies having bearer shares and the fact that they  
will not sign the BOL.

I will see one of the family members tomorrow morning and this still seems to  
have no resolution. This is too important a family in Peru for us not to want  
to do business with, and one that has taken a lot of my time and effort to  
convince to start a relationship with us. Joao Luiz has met members of the  
family as well. I would appreciate your involvement at this point, as this has  
become extremely sensitive.

Thank you and regards,

Jaime



1081

HSBC-OCC\_E 0179327.txt

From: JANET L BURAK/HBUS/HSBC  
Sent: 2/24/2010 9:52:24 PM  
To: BRENDAN MCDONAGH/HBUS/HSBC@HSBC02; IRENE M DORNER/HBUS/HSBC@HSBC02  
Subject: Re: OCC Meeting

The backlog issue is an indisputable problem, and resulted from a number of factors--increase in transaction volumes, increase in alerts due to system changes, law changes and protocol changes (such as MT202COV, which effectively eliminated cover payments) and a failure to increase resources early enough to deal with this. Some of the volume and alert activity should have been anticipated, some could not. The biggest issue for me is that our KRIS did not result in escalation of the problem at an early enough stage so that management could address the issues--the KRIS are being revised, and I do not expect this problem to occur again, but it is taking an enormous effort to eliminate the backlog. You may recall that in December you authorized the hiring of significant temporary staff to work the backlog, and hiring and work began in January.

----- Original Message -----

From: Brendan McDonagh  
Sent: 02/24/2010 08:22 PM CST  
To: Janet Burak; Irene M DORNER  
Subject: Re: OCC Meeting

Let's discuss Monday in NYC when you are back from overseas. I will be in DC on the 16/17/18 March and can see the OCC then.

One fair question is how did the alert backlog buildup?

----- Original Message -----

From: Janet L Burak  
Sent: 02/24/2010 08:39 PM EST  
To: Brendan McDonagh; Irene M DORNER  
Subject: OCC Meeting

I met with the OCC today. In light of the extent of our alert backlogs, Sally indicated that they will shortly be issuing a Supervisory Letter finding violations of the requirements to file a SAR in certain defined circumstances, and generally within 30 days of detection of facts that may constitute a basis for filing a SAR. We make a determination of whether or not to file a SAR after an alert is reviewed, and, as you are aware, there are a significant number of aged alerts. While the OCC is unable to point to specific situations where they believe that SARs should have been filed, but were not, they have concluded that, in light of the size of the backlogs, these situations must exist. The letter will reflect the fact that we self-identified the backlog issue, and that are taking actions to address it.

Sally also indicated that they are considering downgrading their assessment of Compliance Risk Management to "weak" from "satisfactory", although Sally indicated that if they make that decision it will not impact the Bank's composite CAMELS rating, which would remain a "2" (satisfactory), and would not likely impact the Management rating component (also a "2"). For Irene's benefit, national banks are rated on a number of component categories--Capital, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk--and those components determine the composite rating of the institution. This is a quite surprising development, since Compliance as a function was deemed effective in the OCC's July 2009 report of examination, and the OCC's July 2009 separate Compliance Management examination also concluded that compliance management was satisfactory. While the latter report indicated that compliance leadership needed to be strengthened in the BSA/AML area, and recommended the hiring of a dedicated and qualified BSA/AML Officer, it also noted that a search was then underway at the time to fill this position. Sally indicated that the reason for their reconsidering their assessment

Page 1

Permanent Subcommittee on Investigations

EXHIBIT #98

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ings, Inc. HSB03790957  
HSBC OCC 3405315

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 relates to the issues they have identified coming out of the "expanded banknotes examination" as well as the fact that there is an ongoing third party investigation of our BSA/AML compliance (I assume a reference to the DOJ). While we are finalizing our review of the examples they provided us 10 days ago, Wyn has told me that we are not finding anything which points to a systemic problem rather than one-offs (if that). As such, I am inclined to believe this may be more about an OCC concern that if the DOJ investigation actually results in a negative finding, the OCC will be criticized for not having identified and acted on those issues earlier. We intend to provide the OCC with a response next week to the issues they identified, and I am hopeful that the response will positively influence their view on Compliance Risk Management. If that appears to not be the case, I think that we will need to take this to DC (Grace Bailey), as this is becoming an untenable situation.

Please let me know if you have any questions.

Janet L. Burak  
 SEVP and General Counsel  
 HSBC North America Holdings Inc.  
 HSBC USA Inc.  
 HSBC Bank USA, N.A.  
 452 Fifth Avenue, 7th Floor  
 New York, NY 10018  
 (T) 212-525-6533  
 (F) 212-525-8447  
 email: janet.l.burak@us.hsbc.com

From: David W J BAGLEY  
 Sent: Tue Jun 09 14:07:42 2009  
 To: Emileon ALONSO  
 Cc: Catherine BUSSEY; Matthew J W KING; Michael P GEOGHEGAN  
 Subject: Re: GAO Business reviews - LATAM  
 Importance: Normal

Emileon,

I fully acknowledge the level of priority and focus that you and the team have given to these issues and the progress that has been made particularly in Mexico and have taken all of this into account. Catherine has kept us fully updated and I am also aware of the fact that CNBV has expressed their satisfaction with the progress made. It is important to note that this rating does not signify that we take the view that there has been an inadequate response. For example US has been rated red on some categories of risk in the GAC risk map because of inherent risk.

The basis for the rating is however:

The inherent AML risk in Mexico is still very high and there are not many other parts of the Group that have what is effectively a drugs war being conducted on the streets and also have the risk posed by potential sting and other operations by the US authorities. We have of course remediated our high risk accounts, but the historic weak account opening processes mean that we have overall lower levels of KYC across the customer base as a whole. There are other countries within CA where we have ongoing remediation projects including Panama and Costa Rica where again there is a raised AML risk where it is not yet clear to me that we have completed the remediation of high risk accounts.

Happy to discuss further.

Regards

Confidential - FOIA Treatment Request

Permanent Subcommittee on Investigations

EXHIBIT #99

HSBC OCC 8874895



Comptroller of the Currency  
Administrator of National Banks

Washington, DC 20219

September 20, 2012

The Honorable Carl Levin  
Chairman  
Permanent Subcommittee on Investigations  
United States Senate  
Washington D.C. 20510

Dear Chairman Levin:

Thank you for your letter of August 2, 2012, following up on the Permanent Subcommittee on Investigations' July 17, 2012, hearing on *U.S. Vulnerabilities to Money Laundering, Drugs and Terrorist Financing: HSBC Case Study*.

At the hearing, I confirmed the OCC's support of the recommendations contained within the Subcommittee's staff report to strengthen our BSA/AML supervision. This letter provides you a brief update on the actions we have taken since that hearing to implement the report's recommendations.

On July 18, 2012, I notified all OCC staff of my commitment to adopt and implement the recommendations, and I described other changes we are making to enhance our supervisory process. As I stated at the hearing, it is my objective to promote an environment within the OCC that will empower our examiners to conduct effective BSA/AML examinations and escalate any findings of deficiencies to appropriate agency departments for action. A copy of my message to our staff is enclosed.

On August 1, 2012, we issued Supervisory Memorandum SM 2012-3, "Consideration of Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Examination Findings in the Uniform Interagency Rating Systems and OCC's Risk Assessment System" to all examining personnel (copy enclosed). This memorandum provides that, effective July 18, 2012, the results of a BSA/AML examination are no longer considered under the Federal Financial Institutions Examination Council's (FFIEC) Uniform Interagency Consumer Compliance Rating System. Consistent with the Subcommittee's recommendation, OCC examiners are now required to incorporate BSA/AML examinations findings as part of the Management component rating when determining bank ratings in accordance with the FFIEC Uniform Financial Institutions Rating System (CAMELS ratings). This guidance also clearly states our policy that a presumption exists that serious deficiencies in a bank's BSA/AML compliance area could adversely affect a bank's Management component rating.

Permanent Subcommittee on Investigations  
**EXHIBIT #100**

PSI-OCC-45-000001

I also committed to revising and clarifying the operation of our cross-functional Large Bank Review Team. Pursuant to this commitment, we issued Supervisory Memorandum SM 2012-5, "Bank Secrecy Act Large Bank Review Team Structure and Operation" that more clearly defines the mission, membership, organizational structure and functions of the Large Bank Review Team. This guidance implements our policy designed to ensure that appropriate steps are taken in a timely fashion to address BSA/AML deficiencies identified in national banks and federal savings associations and includes provisions to ensure that I and the OCC's Executive Committee are briefed on the Review Team's activities on a regular basis.

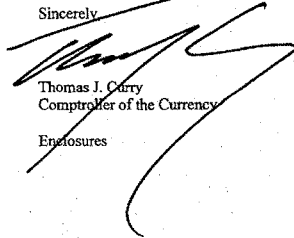
Furthermore, I directed the OCC's Committee on Bank Supervision and Ombudsman Office to develop a process that will provide examiners with a mechanism to appeal a supervisory issue directly to me. I have reviewed their recommendations and the internal appeals process will commence on October 1, 2012.

Finally, we are in the process of drafting policies and procedures for citation of violations in components of a bank's BSA compliance program. We agree with the Subcommittee's recommendation that this flexibility will provide our examiners another mechanism to address weaknesses and violations related to compliance program components.

Compliance with BSA/AML is a safety and soundness issue and a matter of national security. Under my leadership, the OCC will continue to implement the needed changes to ensure the safety and soundness and integrity of the U.S. financial system.

We would be happy to provide additional information about our continued progress in implementing the Subcommittee's recommendations, should that be helpful. Please feel free to have your staff contact Carrie Moore, Director for Congressional Liaison, at 202-874-4844, to arrange such a briefing.

Sincerely,



Thomas J. Curry  
Comptroller of the Currency

Enclosures

**OCC News**

Posted on July 18, 2012

To: All OCC Employees  
 From: Thomas J. Curry  
 Date: July 18, 2012  
 Subject: Lessons From Our Experience With HSBC

On July 17, Deputy Chief Counsel Dan Stipano and Grace Dailey from Large Bank Supervision joined me in testifying before the Senate's Permanent Subcommittee on Investigations regarding our supervision of HSBC Bank USA, N.A., and its BSA/AML program. The hearing followed a year-long investigation by the subcommittee into BSA/AML failures at HSBC. I want to thank the dozens of OCC team members who participated in interviews during the investigation and helped prepare Grace, Dan, and me for the hearing.

There are important lessons from this experience that we must use to improve our supervision of BSA/AML issues. BSA/AML is more than just a compliance issue. It is an issue of safety and soundness and a matter of national security. As the investigation showed, we could have and should have acted sooner. We must be vigilant in banks and savings associations of every size.

To enhance our supervision of BSA/AML across all of the banks we supervise, we embrace the three recommendations from the subcommittee's report. Interim guidance on implementing these recommendations will be provided shortly, to be followed by revisions to our examination policies and procedures.

First, effective immediately we will no longer reflect BSA/AML findings in the "compliance" rating, rather we will fully consider BSA/AML findings in a safety and soundness context as part of the "management" component of a bank's CAMELS rating. Examiners should presume that serious deficiencies in a bank's BSA/AML compliance area adversely affect a bank's management component rating.

Second, we are clarifying the operation of our Large Bank BSA Review Team to ensure we bring different perspectives to bear and react more quickly when a bank has multiple matters requiring attention, or apparent violations of its BSA/AML program. We will also explore how we track and review relevant information and whether additional initiatives are appropriate.

<http://domino02.occ/apps/pa/occnews.nsf/f439d4ef036891b2852570ab00725cf4/13db54e24...> 9/6/2012  
 PSI-OCC-45-000003

Third, we will provide more flexibility for citing BSA/AML violations for individual "pillar" violations, and we will identify what steps we can take in our examinations to obtain a holistic view of a bank's BSA/AML compliance more promptly. In implementing these changes, we must take care not to create disincentives to making the tough calls. That is fundamentally our job.

More generally, we will also review training, staffing, recruitment, policies, and interagency coordination to make improvements in our BSA/AML supervision program.

Finally, we must foster a culture that encourages people to speak up about weakness at the banks we supervise and to escalate those views for action.

Ours is a difficult and important mission. I am proud to be part of this team of dedicated professionals, and I appreciate the extraordinary effort of everyone working to ensure that the financial institutions we supervise operate in a safe, sound, and fair manner.

My oral statement and testimony are available on OCC.gov.

Date | Title | Sequence Number

<http://domino02.occ/apps/pa/occnews.nsf/f439d4ef036891b2852570ab00725cf4/13db54e24...> 9/6/2012  
PSI-OCC-45-000004



## SUPERVISORY MEMORANDUM

Comptroller of the Currency  
Administrator of National Banks

SM 2012-3

Washington, DC 20219

To: All Examining Personnel

From: Committee on Bank Supervision

Date: August 1, 2012

Subject: Consideration of Bank Secrecy Act/Anti-Money Laundering Examination Findings in the *Uniform Interagency Rating Systems* and *OCC's Risk Assessment System*

This memorandum provides interim guidance for incorporating Bank Secrecy Act/Anti-Money Laundering (BSA/AML) examination findings into the CAMELS ratings and the OCC's risk assessment system (RAS) assigned to national banks and federal savings associations (collectively, banks).<sup>1</sup> This guidance also applies to federal branches and agencies of foreign banking organizations.

### Consumer Compliance Rating

Effective July 18, 2012, the results of a BSA/AML examination are no longer to be considered when assigning a rating under the Federal Financial Institutions Examination Council's (FFIEC) Uniform Interagency Consumer Compliance Rating System.

### Management Component Rating

In keeping with current policy, examiners must consider BSA/AML examination findings in a safety and soundness context as a part of the management component of a bank's FFIEC Uniform Financial Institutions Rating System (CAMELS ratings). For federal branches and agencies, BSA/AML examination findings must be considered as part of the risk management component of the ROCA rating system.<sup>2</sup> Examination procedures used to evaluate the adequacy of a bank's BSA/AML compliance remain unchanged.

<sup>1</sup> This supervisory memorandum (SM) rescinds SM 2006-2 (issued as MM 2006-2), "Incorporating BSA, AML, OFAC, and USA PATRIOT Act Compliance into Supervisory Ratings," as well as SM 2004-1 (issued as MM 2004-1), "BSA Examinations."

<sup>2</sup> ROCA stands for Risk management, Operational controls, Compliance, and Asset quality.

PSI-OCC-45-000005



In addition, serious deficiencies in a bank's BSA/AML compliance area will create a presumption that the bank's management component rating will be adversely affected. For example, significant deficiencies in a bank's compliance with BSA/AML that result in an overall BSA compliance program violation<sup>3</sup> would reflect risk management practices that are less than satisfactory and would generally warrant a management rating of "3." Other adverse BSA/AML findings, such as those resulting in "Matters Requiring Attention" (MRA) or less severe enforcement actions, may also negatively affect a bank's management component rating, depending on the circumstances. This may be the case, for example, when a bank has BSA/AML-related MRAs across several lines of business. If, however, management is already deemed in need of improvement and risk management practices are deemed less than satisfactory as reflected in a "3" management rating, a further downgrade in the rating as a result of BSA/AML deficiencies may not be warranted. On the other hand, for those situations that raise greater supervisory concerns, a downgrade of the management component beyond a "3" may be appropriate. Notwithstanding the circumstances, the support for the management rating should be fully documented in the appropriate supervisory system. In addition, examiners should be alert to situations in which management weaknesses identified in other areas of a bank reveal potential deficiencies in BSA/AML program oversight.

#### **Risk Assessment System**

While examiners will no longer consider BSA/AML examination findings as a part of the interagency consumer compliance rating, BSA/AML findings are still considered as a part of compliance risk under the OCC's RAS. Compliance risk considers a bank's compliance with all applicable laws and regulations. The overall quantity of risk and quality of risk management related to BSA/AML compliance as well as the four pillars of a bank's BSA/AML program are considered in assessments of compliance risk. BSA/AML examination findings should also continue to be reflected in the OCC's assessments of reputation, strategic, and operational risks, as applicable.

The Committee on Bank Supervision expects to incorporate this guidance into revisions of the "Bank Supervision Process," "Large Bank Supervision," and "Community Bank Supervision" booklets of the *Comptroller's Handbook*—and other guidance and systems, as needed—by September 2012.

<sup>3</sup> Overall BSA compliance program violations are citations of 12 CFR 21.21 for national banks or 12 CFR 163.177 for federal savings associations. These violations are cited for deficiencies that render the BSA compliance program ineffective when viewed as a whole and result in the issuance of a cease and desist order.



## SUPERVISORY MEMORANDUM

Comptroller of the Currency  
Administrator of National Banks

SM 2012-5

Washington, DC 20219

To: All Examining Personnel

From: Committee on Bank Supervision

Date: August 17, 2012

Subject: Bank Secrecy Act Large Bank Review Team Structure and Operation

The Office of the Comptroller of the Currency (OCC) established a cross-functional Large Bank Review Team (LB Review Team) to ensure bank supervision and enforcement consistency in the area of Bank Secrecy Act/Anti-Money Laundering (BSA/AML) compliance. The LB Review Team is also part of the OCC's "Process for Taking Administrative Enforcement Actions Against Banks Based on BSA Violations," as outlined in OCC Bulletin 2005-45,<sup>1</sup> which states that potential BSA compliance program violations are to be considered by a review group.

The LB Review Team comprises the Director of the Enforcement and Compliance Division, the Senior Counsel for BSA/AML, the Director for BSA/AML Compliance Policy, and the Midsize Bank Supervision Risk Officer. The team's objective is to provide expert input into the supervisory process and develop recommendations to promote and ensure consistency in BSA compliance and enforcement across the LB population.

To this end, the LB Review Team:

- reviews and provides written comments, recommendations, and conclusions in a timely manner on all draft supervisory letters and conclusion memoranda related to LB BSA/AML and Office of Foreign Assets Control (OFAC) matters to ensure they are consistent with OCC policy.
- reviews all proposed LB BSA/AML and OFAC enforcement actions and terminations to ensure they are well supported and consistent with the "Interagency Statement on Enforcement of Bank Secrecy Act/Anti-Money Laundering Requirements" as well as with the OCC's "Process for Taking Administrative Enforcement Actions Against Banks Based on BSA Violations" and other applicable guidance.
- makes reasonable efforts to resolve in a timely manner any disagreements that may arise with LB Supervision on BSA/AML and OFAC-related matters.
- reports on its activities to the Comptroller and Executive Committee on a regular basis.

<sup>1</sup> The BSA enforcement process set forth in OCC Bulletin 2005-45 has not yet been formally applied to federal savings associations through rescission pronouncements; however, the OCC applies this process for both national banks and federal savings associations.

PSI-OCC-45-000007

Accordingly, LB Supervision:

- provides the LB Review Team with complete and timely BSA supervisory letters and conclusion memoranda, including relevant BSA/AML/OFAC "Matters Requiring Attention."
- incorporates LB Review Team comments, recommendations, and conclusions into supervisory letters and conclusion memoranda, making reasonable efforts to resolve in a timely manner any disagreements that may arise with the LB Review Team.
- provides the LB Review Team with written explanations of any disagreements with its comments, recommendations, and conclusions.
- provides the LB Review Team with final copies of the supervisory letters upon issuance to the bank and the final version of the conclusion memoranda upon completion.

If agreement cannot be reached between the LB Review Team and LB Supervision, the matter will be referred to the Committee on Bank Supervision (the Senior Deputy Comptrollers for LB Supervision, Midsize and Community Bank Supervision, and the Chief National Bank Examiner), the Chief of Staff, and the Senior Deputy Comptroller and Chief Counsel (collectively, "the Committee"). If agreement cannot be reached by the Committee, the Senior Deputy Comptroller for LB Supervision will consult with the Comptroller, who may elect to decide the matter under the May 10, 2012, delegation of authority.



Comptroller of the Currency  
Administrator of National Banks

Washington, DC 20219

September 20, 2012

The Honorable Tom Coburn  
Ranking Member  
Permanent Subcommittee on Investigations  
United States Senate  
Washington D.C. 20510

Dear Ranking Member Coburn:

Thank you for your letter of August 2, 2012, following up on the Permanent Subcommittee on Investigations' July 17, 2012, hearing on *U.S. Vulnerabilities to Money Laundering, Drugs and Terrorist Financing: HSBC Case Study*.

At the hearing, I confirmed the OCC's support of the recommendations contained within the Subcommittee's staff report to strengthen our BSA/AML supervision. This letter provides you a brief update on the actions we have taken since that hearing to implement the report's recommendations.

On July 18, 2012, I notified all OCC staff of my commitment to adopt and implement the recommendations, and I described other changes we are making to enhance our supervisory process. As I stated at the hearing, it is my objective to promote an environment within the OCC that will empower our examiners to conduct effective BSA/AML examinations and escalate any findings of deficiencies to appropriate agency departments for action. A copy of my message to our staff is enclosed.

On August 1, 2012, we issued Supervisory Memorandum SM 2012-3, "Consideration of Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Examination Findings in the Uniform Interagency Rating Systems and OCC's Risk Assessment System" to all examining personnel (copy enclosed). This memorandum provides that, effective July 18, 2012, the results of a BSA/AML examination are no longer considered under the Federal Financial Institutions Examination Council's (FFIEC) Uniform Interagency Consumer Compliance Rating System. Consistent with the Subcommittee's recommendation, OCC examiners are now required to incorporate BSA/AML examinations findings as part of the Management component rating when determining bank ratings in accordance with the FFIEC Uniform Financial Institutions Rating System (CAMELS ratings). This guidance also clearly states our policy that a presumption exists that serious deficiencies in a bank's BSA/AML compliance area could adversely affect a bank's Management component rating.

PSI-OCC-45-000009

I also committed to revising and clarifying the operation of our cross-functional Large Bank Review Team. Pursuant to this commitment, we issued Supervisory Memorandum SM 2012-5, "Bank Secrecy Act Large Bank Review Team Structure and Operation" that more clearly defines the mission, membership, organizational structure and functions of the Large Bank Review Team. This guidance implements our policy designed to ensure that appropriate steps are taken in a timely fashion to address BSA/AML deficiencies identified in national banks and federal savings associations and includes provisions to ensure that I and the OCC's Executive Committee are briefed on the Review Team's activities on a regular basis.

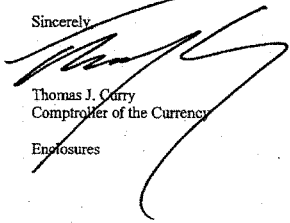
Furthermore, I directed the OCC's Committee on Bank Supervision and Ombudsman Office to develop a process that will provide examiners with a mechanism to appeal a supervisory issue directly to me. I have reviewed their recommendations and the internal appeals process will commence on October 1, 2012.

Finally, we are in the process of drafting policies and procedures for citation of violations in components of a bank's BSA compliance program. We agree with the Subcommittee's recommendation that this flexibility will provide our examiners another mechanism to address weaknesses and violations related to compliance program components.

Compliance with BSA/AML is a safety and soundness issue and a matter of national security. Under my leadership, the OCC will continue to implement the needed changes to ensure the safety and soundness and integrity of the U.S. financial system.

We would be happy to provide additional information about our continued progress in implementing the Subcommittee's recommendations, should that be helpful. Please feel free to have your staff contact Carrie Moore, Director for Congressional Liaison, at 202-874-4844, to arrange such a briefing.

Sincerely,



Thomas J. Curry  
Comptroller of the Currency

Enclosures

## OCC News

Posted on July 18, 2012

To: All OCC Employees  
 From: Thomas J. Curry  
 Date: July 18, 2012  
 Subject: Lessons From Our Experience With HSBC

On July 17, Deputy Chief Counsel Dan Stipano and Grace Dailey from Large Bank Supervision joined me in testifying before the Senate's Permanent Subcommittee on Investigations regarding our supervision of HSBC Bank USA, N.A., and its BSA/AML program. The hearing followed a year-long investigation by the subcommittee into BSA/AML failures at HSBC. I want to thank the dozens of OCC team members who participated in interviews during the investigation and helped prepare Grace, Dan, and me for the hearing.

There are important lessons from this experience that we must use to improve our supervision of BSA/AML issues. BSA/AML is more than just a compliance issue. It is an issue of safety and soundness and a matter of national security. As the investigation showed, we could have and should have acted sooner. We must be vigilant in banks and savings associations of every size.

To enhance our supervision of BSA/AML across all of the banks we supervise, we embrace the three recommendations from the subcommittee's report. Interim guidance on implementing these recommendations will be provided shortly, to be followed by revisions to our examination policies and procedures.

First, effective immediately we will no longer reflect BSA/AML findings in the "compliance" rating, rather we will fully consider BSA/AML findings in a safety and soundness context as part of the "management" component of a bank's CAMELS rating. Examiners should presume that serious deficiencies in a bank's BSA/AML compliance area adversely affect a bank's management component rating.

Second, we are clarifying the operation of our Large Bank BSA Review Team to ensure we bring different perspectives to bear and react more quickly when a bank has multiple matters requiring attention, or apparent violations of its BSA/AML program. We will also explore how we track and review relevant information and whether additional initiatives are appropriate.

<http://domino02.occ.apps/pa/occnews.nsf/f439d4ef036891b2852570ab00725cf4/13db54e24...> 9/6/2012  
 PSI-OCC-45-000011

Third, we will provide more flexibility for citing BSA/AML violations for individual "pillar" violations, and we will identify what steps we can take in our examinations to obtain a holistic view of a bank's BSA/AML compliance more promptly. In implementing these changes, we must take care not to create disincentives to making the tough calls. That is fundamentally our job.

More generally, we will also review training, staffing, recruitment, policies, and interagency coordination to make improvements in our BSA/AML supervision program.

Finally, we must foster a culture that encourages people to speak up about weakness at the banks we supervise and to escalate those views for action.

Ours is a difficult and important mission. I am proud to be part of this team of dedicated professionals, and I appreciate the extraordinary effort of everyone working to ensure that the financial institutions we supervise operate in a safe, sound, and fair manner.

My oral statement and testimony are available on OCC.gov.

Date | Title | Sequence Number

<http://domino02.occ.apps/pa/occnews.nsf/f439d4ef036891b2852570ab00725cf4/13db54e24...> 9/6/2012  
PSI-OCC-45-000012



## SUPERVISORY MEMORANDUM

Comptroller of the Currency  
Administrator of National Banks

SM 2012-3

Washington, DC 20219

To: All Examining Personnel

From: Committee on Bank Supervision

Date: August 1, 2012

Subject: Consideration of Bank Secrecy Act/Anti-Money Laundering Examination Findings in the *Uniform Interagency Rating Systems* and *OCC's Risk Assessment System*

This memorandum provides interim guidance for incorporating Bank Secrecy Act/Anti-Money Laundering (BSA/AML) examination findings into the CAMELS ratings and the OCC's risk assessment system (RAS) assigned to national banks and federal savings associations (collectively, banks).<sup>1</sup> This guidance also applies to federal branches and agencies of foreign banking organizations.

### Consumer Compliance Rating

Effective July 18, 2012, the results of a BSA/AML examination are no longer to be considered when assigning a rating under the Federal Financial Institutions Examination Council's (FFIEC) Uniform Interagency Consumer Compliance Rating System.

### Management Component Rating

In keeping with current policy, examiners must consider BSA/AML examination findings in a safety and soundness context as a part of the management component of a bank's FFIEC Uniform Financial Institutions Rating System (CAMELS ratings). For federal branches and agencies, BSA/AML examination findings must be considered as part of the risk management component of the ROCA rating system.<sup>2</sup> Examination procedures used to evaluate the adequacy of a bank's BSA/AML compliance remain unchanged.

<sup>1</sup> This supervisory memorandum (SM) rescinds SM 2006-2 (issued as MM 2006-2), "Incorporating BSA, AML, OFAC, and USA PATRIOT Act Compliance Into Supervisory Ratings," as well as SM 2004-1 (issued as MM 2004-1), "BSA Examinations."

<sup>2</sup> ROCA stands for Risk management, Operational controls, Compliance, and Asset quality.

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In addition, serious deficiencies in a bank's BSA/AML compliance area will create a presumption that the bank's management component rating will be adversely affected. For example, significant deficiencies in a bank's compliance with BSA/AML that result in an overall BSA compliance program violation<sup>3</sup> would reflect risk management practices that are less than satisfactory and would generally warrant a management rating of "3." Other adverse BSA/AML findings, such as those resulting in "Matters Requiring Attention" (MRA) or less severe enforcement actions, may also negatively affect a bank's management component rating, depending on the circumstances. This may be the case, for example, when a bank has BSA/AML-related MRAs across several lines of business. If, however, management is already deemed in need of improvement and risk management practices are deemed less than satisfactory as reflected in a "3" management rating, a further downgrade in the rating as a result of BSA/AML deficiencies may not be warranted. On the other hand, for those situations that raise greater supervisory concerns, a downgrade of the management component beyond a "3" may be appropriate. Notwithstanding the circumstances, the support for the management rating should be fully documented in the appropriate supervisory system. In addition, examiners should be alert to situations in which management weaknesses identified in other areas of a bank reveal potential deficiencies in BSA/AML program oversight.

#### **Risk Assessment System**

While examiners will no longer consider BSA/AML examination findings as a part of the interagency consumer compliance rating, BSA/AML findings are still considered as a part of compliance risk under the OCC's RAS. Compliance risk considers a bank's compliance with all applicable laws and regulations. The overall quantity of risk and quality of risk management related to BSA/AML compliance as well as the four pillars of a bank's BSA/AML program are considered in assessments of compliance risk. BSA/AML examination findings should also continue to be reflected in the OCC's assessments of reputation, strategic, and operational risks, as applicable.

The Committee on Bank Supervision expects to incorporate this guidance into revisions of the "Bank Supervision Process," "Large Bank Supervision," and "Community Bank Supervision" booklets of the *Comptroller's Handbook*—and other guidance and systems, as needed—by September 2012.

<sup>3</sup> Overall BSA compliance program violations are citations of 12 CFR 21.21 for national banks or 12 CFR 163.177 for federal savings associations. These violations are cited for deficiencies that render the BSA compliance program ineffective when viewed as a whole and result in the issuance of a cease and desist order.



## SUPERVISORY MEMORANDUM

Comptroller of the Currency  
Administrator of National Banks

SM 2012-5

Washington, DC 20219

To: All Examining Personnel

From: Committee on Bank Supervision

Date: August 17, 2012

Subject: Bank Secrecy Act Large Bank Review Team Structure and Operation

The Office of the Comptroller of the Currency (OCC) established a cross-functional Large Bank Review Team (LB Review Team) to ensure bank supervision and enforcement consistency in the area of Bank Secrecy Act/Anti-Money Laundering (BSA/AML) compliance. The LB Review Team is also part of the OCC's "Process for Taking Administrative Enforcement Actions Against Banks Based on BSA Violations," as outlined in OCC Bulletin 2005-45,<sup>1</sup> which states that potential BSA compliance program violations are to be considered by a review group.

The LB Review Team comprises the Director of the Enforcement and Compliance Division, the Senior Counsel for BSA/AML, the Director for BSA/AML Compliance Policy, and the Midsize Bank Supervision Risk Officer. The team's objective is to provide expert input into the supervisory process and develop recommendations to promote and ensure consistency in BSA compliance and enforcement across the LB population.

To this end, the LB Review Team:

- reviews and provides written comments, recommendations, and conclusions in a timely manner on all draft supervisory letters and conclusion memoranda related to LB BSA/AML and Office of Foreign Assets Control (OFAC) matters to ensure they are consistent with OCC policy.
- reviews all proposed LB BSA/AML and OFAC enforcement actions and terminations to ensure they are well supported and consistent with the "Interagency Statement on Enforcement of Bank Secrecy Act/Anti-Money Laundering Requirements" as well as with the OCC's "Process for Taking Administrative Enforcement Actions Against Banks Based on BSA Violations" and other applicable guidance.
- makes reasonable efforts to resolve in a timely manner any disagreements that may arise with LB Supervision on BSA/AML and OFAC-related matters.
- reports on its activities to the Comptroller and Executive Committee on a regular basis.

<sup>1</sup> The BSA enforcement process set forth in OCC Bulletin 2005-45 has not yet been formally applied to federal savings associations through rescission pronouncements; however, the OCC applies this process for both national banks and federal savings associations.

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Accordingly, LB Supervision:

- provides the LB Review Team with complete and timely BSA supervisory letters and conclusion memoranda, including relevant BSA/AML/OFAC "Matters Requiring Attention."
- incorporates LB Review Team comments, recommendations, and conclusions into supervisory letters and conclusion memoranda, making reasonable efforts to resolve in a timely manner any disagreements that may arise with the LB Review Team.
- provides the LB Review Team with written explanations of any disagreements with its comments, recommendations, and conclusions.
- provides the LB Review Team with final copies of the supervisory letters upon issuance to the bank and the final version of the conclusion memoranda upon completion.

If agreement cannot be reached between the LB Review Team and LB Supervision, the matter will be referred to the Committee on Bank Supervision (the Senior Deputy Comptrollers for LB Supervision, Midsize and Community Bank Supervision, and the Chief National Bank Examiner), the Chief of Staff, and the Senior Deputy Comptroller and Chief Counsel (collectively, "the Committee"). If agreement cannot be reached by the Committee, the Senior Deputy Comptroller for LB Supervision will consult with the Comptroller, who may elect to decide the matter under the May 10, 2012, delegation of authority.



Stuart Levey  
Chief Legal Officer

September 11, 2012

By Hand and Electronic Mail

Hon. Carl Levin, Chairman  
Hon. Tom Coburn, Ranking Member  
Permanent Subcommittee on Investigations  
Committee on Homeland Security and Governmental Affairs  
United States Senate  
SR-199 Russell Senate Office Building  
Washington, DC 20510

Dear Chairman Levin and Ranking Member Coburn:

Thank you for the opportunity to testify at the Subcommittee's July 17, 2012 hearing and for the follow-up questions presented in your August 2, 2012 letter and during a call with the Subcommittee staff on August 22, 2012. Responses to these questions follow.

\* \* \* \*

1. At the hearing, HSBC announced that HBIX would be closing all of its U.S. dollar Cayman Island accounts.

a. Will HBIX also close the Cayman Island branch?

Yes.

HSBC Holdings plc  
Level 42, 8 Canada Square, London E14 5HQ  
Web: www.hsbc.com

Registered in England number 6120448 Reg.



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- b. Will some of the Cayman Island accounts, currently described as being serviced through the HBMX Cayman branch, be reopened as accounts at another unit within HBMX or within HSBC? If yes, where will those accounts be located?*

All HSBC Mexico S.A. ("HBMX") Cayman Islands accounts will be closed. Customers who have USD accounts at HBMX's Cayman Islands branch and also have pesos accounts at HBMX, may transfer their funds into their pesos accounts at HBMX when the Cayman Islands accounts are closed. Those who do not hold a peso account at HBMX will receive a check or a transfer of their funds to an account that they designated. The designated account could be an already open account that the customer has at another HSBC affiliate. Additionally, USD Cayman Islands accountholders whose accounts are closed will have the opportunity to open pesos accounts at HBMX, subject to appropriate review and in compliance with established account-opening procedures.

Former HBMX Cayman Islands accountholders may also seek to open new accounts at other HSBC affiliates, subject to Know Your Customer ("KYC") and other account-opening procedures.

- c. Will HSBC continue to service any former Cayman Island clients? If yes, at what locations will these clients be serviced?*

See answer to 1(b) above.

- 2. With regard to Rami Makhlouf (see pages 176 and 177 of the Subcommittee's report), please respond to the following:*

- a. Please provide the date when HBUS added Mr. Makhlouf's name to its OFAC filter.*

HSBC Bank USA, N.A. ("HBUS") added Mr. Makhlouf's name to its OFAC filter on February 21, 2008, the same day he was designated by the U.S. Department of Treasury for corruption.

With respect to questions 2(b)-(d), we are working to provide relevant information consistent with local privacy laws.



3. *On July 25, 2012, HIBMX paid a \$28 million fine that had been imposed on the bank on November 7, 2011, by the CNBV, due to anti-money laundering deficiencies identified in 2007 and 2008. Please explain the deficiencies that served as the basis for the fine and why HIBMX did not pay the fine until July 2012.*

The fine issued by CNBV resulted primarily from untimely filing of unusual transaction reports, all of which HIBMX ultimately filed with the proper authorities. In addition, CNBV identified deficiencies in HIBMX's KYC records, periodic reviews of high-risk customers, systems for monitoring client profiles, and processes for detection, analysis, and reporting of unusual transactions. Following the issuance of the fine in November 2011, HIBMX brought administrative litigation proceedings before the Federal Tax and Administrative Court (Sala Especializada en Resoluciones de Organos Reguladores de la Actividad del Estado - Tribunal Federal de Justicia Fiscal y Administrativa) and indirect proceedings before the Tenth Administrative District Court for the Federal District (Juez Décimo de Distrito en Materia Administrativa en el Distrito Federal) challenging the basis of some of the alleged underlying violations and the amount of the proposed fine. HIBMX, however, voluntarily paid the fine prior to resolution of those proceedings. CNBV made a series of recommendations with respect to identified deficiencies and has confirmed that HIBMX implemented them completely.

4. *Please indicate whether and when HBUS has conducted a due diligence review of HIBMX, the nature of that review, and the results.*

HBUS has conducted a KYC review of all of its HSBC affiliate customers, including HIBMX. As a correspondent banking customer, HIBMX was subject to enhanced due diligence ("EDD"). HBUS completed its initial KYC on HIBMX in September 2010, updated it in 2011, and remediated HIBMX KYC to HBUS' new KYC standards in May 2012. In accordance with HBUS' new KYC policy, the EDD review conducted with respect to HIBMX was a multi-step process that included, among other things: obtaining information concerning the countries where HIBMX has branches and subsidiaries; screening for negative news on the bank; inquiring about HIBMX's banking relationships with other institutions and determining that none has closed HIBMX's account(s) in the last 5 years; obtaining information regarding the type of business HIBMX engages in and whether HBUS believes that business to be high risk; gathering information regarding any regulatory enforcement actions and fines; and gathering detailed information regarding HIBMX's AML policies and procedures.



Furthermore, as recommended in the PSI's July 17, 2012 report, HIBUS has committed to undertaking an additional special review of the HIBMX relationship. Currently, the HIBUS Financial Intelligence Unit ("FIU") is conducting an assessment of, among other things, the economic and security situation in Mexico, the risk associated with the banking services offered by HIBMX, funds flow in and out of Mexico by HIBUS business line, reportable events and suspicious activity reports related to Mexico, and anti-money laundering processes and procedures at HIBMX. Once its assessment is complete, the FIU will issue a report for consideration by HIBUS senior management.

*5. Please provide the date or anticipated date on which affiliates will begin sharing information with one another and the process by which that will be accomplished.*

HSBC has taken steps to enhance information sharing between affiliates. Earlier this year, the new Steering Committee on Global Standards, which I co-chair along with Chief Risk Officer Marc Moses, enacted a new global standard to maximize the sharing of information, to the extent permitted by law, across all HSBC affiliates and all Global Businesses and Functions for risk management purposes. Under this standard, the following enhancements to information sharing have been made:

- HSBC is creating an internal intranet site to facilitate the sharing of Compliance Assurance reports—which provide a summary of the status of material AML and compliance issues in regions and business lines—automatically on a monthly basis. All Regional and Global Business Compliance heads will have access to the reports on this intranet site, which is anticipated to be operational by the end of September this year.
- Compliance Assurance team reports produced after on-the-ground reviews of specific Regional Compliance functions have mandatory distribution to the Regional CEO, Regional CRO, local compliance, and Group Chief Risk Officer.
- HSBC is making changes to its Group Compliance reporting system to allow any material or systemic AML control weakness at any affiliate that is reported by the Regional and Global Business Compliance heads to be viewed by all other Regional and Global Business Compliance heads. These changes are expected to be operational by the end of September this year.



- Over the course of the last year, HSBC has made its Risk Management meetings more effective forums for sharing detailed information about compliance and other risks among affiliates. Among other things, attendees look at a "Risk Map" that identifies risks across the Group, including AML risk. Regional and Global Business heads must take the information they receive at the meetings back to their Compliance and Risk teams.

HSBC will continue to look for additional opportunities to increase the flow of information throughout the Group.

6. *Please provide the names of the HSBC affiliates located in tax havens where jurisdictional differences preclude the sharing of information. Please provide additional detail on relevant privacy restrictions to information-sharing.*

The Bank is not aware of a single, universally agreed-upon list of tax havens. However, the Stop Tax Haven Abuse Act (S. 681), introduced by Chairman Levin in 2007, contains a list of 34 "offshore secrecy jurisdictions," which have been identified publicly as such by the Internal Revenue Service in federal court proceedings. The S. 681 list provides the basis for this response. From the S. 681 list, HSBC has offices in: Bahamas, Bermuda, British Virgin Islands, Cayman Islands, Cook Islands, Costa Rica, Northern Cyprus, Guernsey, Hong Kong, Isle of Man, Jersey, Luxembourg, Malta, Panama, Singapore, and Switzerland. We are compiling a list of citations to the applicable laws in these jurisdictions that we will send to the Subcommittee.

- a. *Please describe what actions HBUS will take or has taken if one of these affiliates does not provide requested information.*

HBUS performs KYC on each of its customers, including its affiliates. In the course of the KYC process, HBUS requests and maintains a significant amount of information relating to all of its customers. This information is collected for multiple purposes, and the consequences of a particular customer's failure to provide requested information will depend on the context. Importantly, HBUS treats its affiliate customers the same as any other third-party customer. Where an affiliate fails to provide requested information after diligent inquiry by HBUS, HBUS will escalate the matter to Group, and as HBUS CEO Irene Dörner testified at the PSI's July 17, 2012 hearing, where an affiliate fails to provide sufficient KYC information, HBUS "would have no hesitation in not opening the account or indeed closing an account."





7. *With regard to bearer share accounts, please provide the number of clients for whom a waiver was granted, from January 1, 2008 to the present, from any HBUS due diligence, beneficial ownership, or anti-money laundering requirement, the nature of the waiver granted, the date on which that waiver was granted, and who granted the waiver.*

As the Committee is aware, accounts of bearer share corporations ("bearer share accounts") were most likely to be held with the private banking entities—the Private Bank International in Miami and the International Private Bank in New York (collectively, "Private Bank America"). With regard to bearer share accounts held at Private Bank America, the Bank is not aware of any waiver granted, on or after January 1, 2008, from any of the due diligence, beneficial ownership, or anti-money laundering requirements in the applicable bearer share policy. The Bank is also undertaking a review to determine if there are bearer share accounts in other HSBC North America Holdings, Inc. ("HNAH") business units. If any are identified, they will be subject to prompt remediation in conformance with HNAH policy.

\* \* \* \*

Thank you for the opportunity to provide this response.

Sincerely,

Stuart Levey  
HSBC Chief Legal Officer



Stuart Levey  
Chief Legal Officer

September 25, 2012

By Hand and Electronic Email

Hon. Carl Levin, Chairman  
Hon. Tom Coburn, Ranking Member  
Permanent Subcommittee on Investigations  
Committee on Homeland Security and Governmental Affairs  
United States Senate  
SR-199 Russell Senate Office Building  
Washington, DC 20510

Dear Chairman Levin and Ranking Member Coburn:

Thank you again for the opportunity to testify at the Subcommittee's July 17, 2012 hearing and for the follow-up questions presented in your August 2, 2012 letter. Responses to questions 2(a) -- (d) follow.

\* \* \*

2. With regard to Rami Makhlouf (see pages 176 and 177 of the Subcommittee's report), please respond to the following:

a. Please provide the date when HBUS added Mr. Makhlouf's name to its OFAC filter.

HSBC Bank USA, N.A. ("HBUS") added Mr. Makhlouf's name to its OFAC filter on February 21, 2008, the same day he was designated by the U.S. Department of Treasury for corruption.

b. What was the approximate maximum amount of funds in the HSBC Cayman Island account that was opened in the name of the trust benefiting Mr. Makhlouf?

/cont'd...

HSBC Holdings plc  
Level 42, 8 Canada Square, London E14 5HQ  
Web: www.hsbc.com

Registered in England number 67799. Registered Office: 8 Canada Square, London E14 5HQ

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As reflected in documents available in the U.S. that have been produced to the Subcommittee (HSBC OCC 0160453), the trust benefiting Mr. Makhoulf was administered by HSBC Geneva (HSBC Cayman did not maintain an account for any trust benefiting Mr. Makhoulf). We are not able to provide the information requested because relevant privacy laws restrict HSBC's ability to discuss confidential client information.

- c. *Is that account or any other HSBC account benefiting Mr. Makhoulf still open? If yes, please identify the HSBC affiliate where each such account is located, and indicate whether and when that account has been frozen.*

As described above, the trust benefiting Mr. Makhoulf was administered by HSBC Geneva. Mr. Makhoulf was removed as a beneficiary of the trust after his February 21, 2008 designation by the U.S. Department of Treasury for corruption.

Current privacy laws restrict HSBC's ability to discuss confidential client information in specific jurisdictions. HSBC is committed to complying with applicable sanctions and where accounts are subject to sanctions, HSBC's policy is to freeze accounts as required. Additionally, HSBC does not hold any accounts by or for the benefit of Mr. Makhoulf in countries where sanctions do not apply.

- d. *When HSBC Cayman Islands raised concerns with regard to Mr. Makhoulf's accounts in 2007,*

- i. *What were the concerns raised by HSBC Cayman Islands?*

As reflected in documents available in the U.S. that have been produced to the Subcommittee (HSBC OCC 0160453), HSBC Cayman raised questions about the appropriateness of the relationship with Mr. Makhoulf in August 2007, prior to the sanctioning of Mr. Makhoulf in any jurisdiction. HSBC Cayman's concerns were based on media coverage regarding the Makhoulf family. After Mr. Makhoulf's designation by the U.S. Department of Treasury for corruption on February 21, 2008, he was removed as a beneficiary of the trust.

- ii. *What steps did HSBC Group take to address those concerns?*

HSBC Group Compliance, Risk, Security, and the relevant business conferred and worked together to assess the relationship.

/cont'd ...

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*iii. Who at HSBC Group was responsible for making a determination about this account?*

As explained above, different parts of HSBC Group, including, among others, Compliance, Risk, Security, and the relevant business were involved.

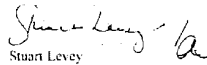
*iv. Why did HSBC allow an international terrorist to maintain an account with the bank?*

As referenced above, Mr. Makhlof was designated by the U.S. Department of Treasury for corruption and was added to HBUS' filter on the same day. HSBC is committed to complying with applicable sanctions and where accounts are subject to sanctions, HSBC's policy is to freeze accounts as required. HSBC is moving to implement a new global sanctions policy under which HSBC will screen for key illicit actors designated by OFAC in all jurisdictions, in all currencies.

\* \* \*

Thank you for the opportunity to provide this response.

Sincerely,

  
Stuart Levey  
HSBC Chief Legal Officer

PSI-HSBC-81-000003

